STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
POWER AND CHEMICAL PRODUCTS, INC.	:	DETERMINATION DTA NO. 818527
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, 1994 through May 31, 1999.	:	

Petitioner, Power and Chemical Products, Inc., 7 W. Albany Street, Huntington Station, New York 11746, 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 December 1, 1994 through May 31, 1999.

On February 13, 2002, petitioner, by Anthony Lombardozzi, president, and the Division of Taxation, by Barbara G. Billet, Esq. (Jennifer A. Murphy, Esq., of counsel), waived a hearing and agreed to submit this matter for determination based on documents and briefs submitted by May 28, 2002, which date began the six-month period for the issuance of this determination. After review of the evidence and arguments presented, Timothy J. Alston, Administrative Law Judge, renders the following determination.

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioner has shown error in either the audit method or result.

II. Whether penalties imposed pursuant to Tax Law § 1145(a)(1)(i) and (vi) should be sustained.

FINDINGS OF FACT

1. On March 27, 2000, following an audit, the Division of Taxation ("Division") issued to petitioner, Power and Chemical Products, Inc., a Notice of Determination which asserted $32,946.10 in sales and use taxes due, plus penalty and interest, for the period December 1, 1994 through May 31, 1999.

2. Petitioner sold and serviced outdoor equipment, such as tractors, mowers and snow plows; indoor equipment, such as floor machines, buffers, and vacuums; and also sold janitorial, chemical and cleaning supplies.

3. Pursuant to a Conciliation Order dated February 23, 2001, the Division modified the tax deficiency to $23,677.66, plus penalty and interest.

4. To begin the audit process, the Division mailed to petitioner an audit appointment letter dated November 21, 1997 to schedule the commencement of the audit. This letter requested that petitioner make available for review its books and records for the audit period, listed in the letter as December 1, 1994 through November 30, 1997. Following a review, the Division determined that petitioner's records for this period were adequate to conduct a detailed audit.

5. Petitioner consented to a test period audit of its sales and recurring expense purchases for the December 1, 1994 through November 30, 1997 period by its execution of a Test Period Audit Election Method form. This form, signed by petitioner's president, Anthony Lombardozzi, on July 31, 1998, provided in part: "The Department of Taxation and Finance Representative has explained to me the various audit methods listed above. I agree the audit should be conducted using a **Test Period Method Audit**." (Emphasis in original.)

6. The Division selected March 1, 1997 through May 31, 1997 as the test period and examined petitioner's sales in detail for this period. Following this examination, the Division

disallowed as unsubstantiated some 31 transactions, which totaled $15,478.91 in claimed exempt or nontaxable sales for this period. Next the Division determined an error rate of 263.40 percent by calculating the ratio of disallowed unsubstantiated exempt sales for the test period ($15,478.91) to reported taxable sales for the same period ($5,876.65). The Division then multiplied this error rate by petitioner's reported taxable sales for each sales tax quarter of the audit period to reach unsubstantiated exempt sales for the audit period. Next, the Division added this unsubstantiated exempt sales figure to reported taxable sales to reach audited taxable sales for the audit period. The Division then applied the prevailing sales tax rate to audited taxable sales and, after allowing for tax previously paid, determined audited tax due on sales for the audit period.

7. The Division also audited petitioner's expense purchases using a test period method. Specifically, the Division calculated the ratio of taxable expense purchases where tax was not paid to petitioner's total sales during the test period per its cash receipts journal. The Division determined this ratio, or error rate, to be .07 percent. Next the Division multiplied this error rate by petitioner's sales per its cash receipts journal for each sales tax quarter of the audit period, resulting in additional tax due on purchases of $50.75 for the audit period. Petitioner has not protested this component of the assessment.

8. By letter dated December 1, 1999, the Division advised petitioner that the audit period was being expanded to include the period June 1, 1998 through May 31, 1999. The letter further requested that petitioner make its books and records available for this updated period.

9. Petitioner did not respond to this request and the Division determined audited taxable sales for this updated period by applying the error rate of 263.40 percent to petitioner's reported

taxable sales for this period and calculating additional tax due on sales for this expanded audit period in the manner described above in Finding of Fact "6."

10. As noted above, pursuant to a Conciliation Order dated February 23, 2001, the Division modified the tax deficiency to $23,677.66, plus penalty and interest. This reduction was based upon additional evidence submitted by petitioner that substantiated the tax exempt status of some of its sales during the test period. As a result of this modification the number of disallowed transactions was reduced from 31 to 18 and the error rate was reduced from 263.40 to 182.20 percent. Application of this error rate to reported taxable sales throughout the audit period resulted in the revised deficiency.

11. The Division imposed underreporting penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi). Penalties under Tax Law § 1145(a)(1)(vi) are imposed where the underreporting of tax is greater than 25 percent of the amount required to be reported. Petitioner's reported taxable sales during the period at issue were $105,556.00. Petitioner's audited taxable sales, after allowing for the adjustments made following the conciliation conference, were $388,010.89.

12. As noted, following the Conciliation Order adjustments, the remaining deficiency results from the Division's disallowance of 18 transactions during the test period which were claimed by petitioner as nontaxable. The auditor's workpapers describe the customers in these transactions as follows:

Reference No.	*Customer*
1	Church Home Associates
2	Tower West Associates/GRC
8	1199 Housing Corp.
11	Chatham Green Towers
14	Unidentified - No Tax
17	Riverside Drive
26	Brigham Park Coop Apts. S3
27	Brigham Park Coop Apts. S3

29	Grand St. Guild
31	Nick Mancuso
42	Church Homes Assoc
47	Vinny Giglis
61	Cash Sales - L. Stebbins
62	Cash Sales - D. Scarsella
64	Mr. Schmidt
65	Cash Sales - Mr. Bullock
66	Cash Sales - Mr. Phil Beck
67	Cash Sales - Mrs. Bay

13. With respect to transactions 11, 17, 26, and 27, the Division determined that petitioner collected, but did not remit, sales tax. The Division made this determination following a review of petitioner's cash receipts journal and invoices, which showed that sales tax was charged on the invoice, but recorded in the cash receipts journal as a nontaxable sale. In transactions 47 and 62, small differences between sales tax collected and reported and sales tax due indicate an apparent miscalculation of tax liability. The Division's review also indicated that petitioner failed to report transactions 61, 64, 65, 66, and 67.

CONCLUSIONS OF LAW

A. The Division's use of a test period audit method to determine petitioner's sales tax liability was proper. With respect to the period December 1, 1994 through November 30, 1997, petitioner's written consent authorized the Division to use such a method (***see***, ***Wallach v. Tax Appeals Tribunal*** 206 AD2d 696, 614 NYS2d 647, ***lv denied*** 85 NY2d 805, 626 NYS2d 756). With respect to the period June 1, 1998 through May 31, 1999, the Division's authority to use the test period method derived from petitioner's failure to respond to the Division's written request for records for that period. The Division's December 1, 1999 letter was a clear and unequivocal request for records (***see***, ***Christ Cella v. State Tax Commn.***, 102 AD2d 352, 477 NYS2d 858). Petitioner's failure to produce records in response to that request authorized the

use of a test period audit method (***see***, ***Continental Arms Corp. v. State Tax Commn.***, 72 NY2d 976, 534 NYS2d 362).

B. Petitioner denied that it failed to provide records with respect to the updated audit period. In its reply brief petitioner's president asserted that petitioner provided the auditor with all requested items and that, if the auditor needed additional records, all she had to do was to ask. The record, however, shows that the Division requested records for the updated period by letter dated December 1, 1999 and there is no evidence that petitioner responded to this request. The Division thus was authorized to use the test period method for the updated audit period.

C. Petitioner also asserted that the audit method used by the Division was "at the very least unfair" and that "to make the assumption that the same error has occurred in each and every quarter of the audit period is not only wrong but impossible." Regarding these contentions, where, as here, the Division properly uses an estimate method of audit, such as a test period, such method must be reasonably calculated to reflect tax due (***see***, ***Matter of Grecian Square v. State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219) Under such circumstances, exactness is not required in the determination of sales tax liability (***see***, ***Meyer v. State Tax Commn.***, 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025). The test period is well established as an acceptable audit method (***see***, ***e.g.***, ***Wallach v. Tax Appeals Tribunal***, ***supra***) and the use of data from a prior period to determine tax is acceptable (***see***, ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454.)

D. Where, as in the instant matter, a test period audit has been properly used, the burden of proof lies with the taxpayer to show by clear and convincing evidence that the audit method was unreasonable or that the results were unreasonably inaccurate (***see***, ***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679). In this case, the sales tax deficiency results

from the Division's determination that 18 of petitioner's sales during the test period, reported as nontaxable (or not reported at all), were properly subject to tax. Pursuant to Tax Law § 1132(c)(1), all of the transactions at issue were presumptively taxable and the burden of proving that any or all of these transactions were not subject to tax was on petitioner. Upon review of the record, it is clear that petitioner has failed to meet this burden.

E. Petitioner asserted that the two sales to Church Home Associates during the test period were exempt because Church Home Associates was, during that time, a limited dividend housing company, an entity exempt from sales tax. Petitioner asserted that Church Home Associates' status had changed in the past ten years and that, during the test period, it was exempt. In support of this assertion, petitioner submitted a history of this account showing that petitioner charged Church Home Associates sales tax on a 1992 sale; did not charge sales tax on sales from 1994 to 1997, and 1999; and charged sales tax on sales from 1999 to 2002. While this evidence shows changes in petitioner's tax treatment of its sales to Church Home Associates, it does not establish that Church Home Associates was properly exempt from sales tax during the test period (or, indeed, at any time during the audit period). Accordingly, given the presumption of taxability under Tax Law § 1132(c)(1), these transactions are properly deemed taxable.

F. Petitioner also asserted that it made sales to New York City Public School custodians and that such sales were exempt from tax. While petitioner submitted evidence in support of the assertion that sales directly to New York City Public School custodians are exempt, petitioner submitted no evidence to show that any of the test period transactions were, in fact, sales to New York City Public School custodians. In the absence of any such evidence, there is no basis upon which to make any adjustment to the assessment.

G. Petitioner also took issue with the Division's claim that petitioner collected, but did not remit sales tax with respect to four sales during the test period. Petitioner asserted that the auditor could not have tracked an invoice to petitioner's cash receipts journal and therefore could not have determined whether tax was remitted on these sales. As noted previously, petitioner has the burden of proving that the tax deficiency is erroneous. Petitioner offered no evidence to show that the tax collected on these four transactions was remitted to the Division. Accordingly, there is no basis upon which to make any adjustment to the assessment.

H. The Division asserted penalty herein pursuant to Tax Law § 1145(a)(1)(i) and (vi). Tax Law § 1145(a)(1)(i) states that any person failing to file or pay over any sales or use tax to the Commissioner of Taxation and Finance ("the Commissioner") "shall" be subject to a penalty. This penalty may be canceled if the Commissioner determines that the failure was "due to reasonable cause and not due to willful neglect" (Tax Law § 1145[a][1][iii]). Consistent with this statute, the Commissioner's regulations provide that penalty imposed under Tax Law § 1145(a)(1)(i) "must be imposed unless it is shown that such failure was due to reasonable cause and not due to willful neglect" (20 NYCRR 2392.1[a][1]).

Tax Law 1145(a)(1)(vi) states that any person who omits from the total amount of tax required to be shown on a sales tax return an amount which is in excess of 25 percent of such total amount "shall be subject to a penalty equal to ten percent of the amount of such omission." Here, petitioner reported $105,556.00 in taxable sales for the audit period and, following adjustments made after the conciliation conference, the Division determined $388,010.89 in audited taxable sales. Petitioner thus underreported taxable sales by more than 25 percent and was therefore properly subject to the section 1145(a)(1)(vi) penalty. Like the penalties imposed

under Tax Law § 1145(a)(1)(i), penalties imposed under section 1145(a)(1)(vi) must be remitted if the failure was due to reasonable cause and not due to willful neglect.

I. In the instant matter, petitioner has offered no evidence of reasonable cause or an absence of willful neglect. Accordingly, the imposition of penalties must be sustained.

J. The petition of Power and Chemical Products, Inc. is denied and the Notice of Determination dated March 27, 2000, as modified by the Conciliation Order dated February 23, 2001, is sustained.

DATED: Troy, New York
November 14, 2002

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE