STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CASE TIRE SERVICE, INC.	:	SMALL CLAIMS DETERMINATION DTA NO. 820162
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 June 1, 2000 through May 31, 2003.	:	

Petitioner, Case Tire Service, Inc., 302 Grandview Avenue, Honesdale, Pennsylvania 18431, 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 June 1, 2000 through May 31, 2003.

A small claims hearing was held before James Hoefer, Presiding Officer, at the offices of the Division of Tax Appeals, 44 Hawley Street, Binghamton, New York, on December 15, 2005 at 10:00 A.M. Petitioner appeared by Robert Rossi & Co. (Sean J. Grassi, CPA). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (L. Scott Bensen).

Since neither party wished to file a post hearing brief, the three-month period for the issuance of this determination commenced as of the date the hearing was held.

ISSUE

Whether the Division of Taxation properly determined that petitioner owed additional tax due for purchases subject to use tax based on the results of a test period audit which were projected over the entire audit period.

FINDINGS OF FACT

1. Petitioner, Case Tire Service, Inc., ("Case Tire") was incorporated on June 14, 1994 and it has, since its inception, elected to be treated as an S corporation. Petitioner's primary business activity, as its name suggests, involves the retail sale and mounting of automotive tires. Petitioner also performs minor repair work, such as oil changes, alignments, brakes and New York State inspections; however, the bulk of petitioner's business centers around the sale and installation of tires. Petitioner is headquartered in Honesdale, Pennsylvania, and it maintains two retail store locations, one in Pennsylvania and one just over the Pennsylvania/New York border in Port Jervis, New York. From a review of the business allocation percentages, as reported on petitioner's New York State corporation franchise tax returns for the 2001 and 2002 calendar years, it can be seen that approximately 24% of petitioner's sales occurred in New York State during this two-year period.

2. In June 2003, the Division of Taxation ("Division") commenced a field audit of Case Tire's books and records to determine if it had collected and remitted the proper sales and use taxes due for the period June 1, 2000 through May 31, 2003. Petitioner's sales and use tax returns for the three years under review reported gross sales of $2,429,570.00, taxable sales of $1,755,197.00 and that it had made no purchases subject to use tax. On audit, the Division determined that petitioner's sales records were complete and accurate and that gross sales per books and records reconciled with Federal income tax returns and New York State sales and use tax returns. Using April 2003 as a test period, the Division concluded that petitioner's sales tax returns accurately reported taxable sales, that petitioner maintained the required sales records and exemption certificates to substantiate claimed nontaxable sales and that the proper sales tax had

been collected and remitted. Accordingly, the Division accepted gross and taxable sales as reported by petitioner on its sales and use tax returns for the audit period.

3. The Division next performed a review of purchase records to determine if petitioner had purchased taxable items, such as shop supplies, tools and other miscellaneous taxable items, tax free. Partial purchase records were reviewed for the quarter December 1, 2002 through February 28, 2003 and it was found that petitioner had made 23 taxable purchases, totaling $3,658.90, on which no sales tax had been paid. Applying the 7.25% tax rate to audited taxable purchases produced a tax due of $265.32 for the test period. The tax due of $265.32 was divided by reported gross sales for the test period of $176,902.00 to arrive at an error rate of .15%. The .15% error rate was applied to reported gross sales for the audit period to calculate a use tax due on purchases of $3,644.34.

The Division also performed a review of assets acquired by petitioner during the audit period. This review revealed that petitioner made only one asset acquisition during the audit period, a machine to aim headlights, at a cost of $749.00. Since no sales tax was paid on this purchase, the Division determined that $54.30 of sales tax was due ($749.00 x 7.25%). Petitioner concedes that it is liable for payment of the $54.30 of tax due on the fixed asset acquisition.

4. On December 26, 2003, the Division issued a Notice of Determination ("Notice") to petitioner asserting that $3,698.64 ($3,644.34 + $54.30) of tax was due, together with penalty of $1,179.78 and interest of $1,016.54, for a total amount due of $5,891.96. Petitioner timely contested the Notice by filing a Request for Conciliation Conference with the Division's Bureau of Conciliation and Mediation Services ("BCMS"). On June 18, 2004, BCMS issued a Conciliation Order which sustained the tax due, canceled penalty and reduced interest to the

minimum rate. Petitioner contested the Conciliation Order by filing a petition with the Division of Tax Appeals and this small claims hearing ensued.

5. The 23 taxable purchases which the Division discovered during its test period audit of purchases consisted of the following items:

ITEM	NUMBER	AMOUNT
Store cleaning	12	$420.00
Snow plowing	8	1,805.00
Tire disposal	2	1,131.90
Equipment repair	1	302.00
Total	23	$3,658.90

6. Petitioner concedes that the two tire disposal fees and one equipment repair were taxable purchases, that there was sufficient relationship between these three purchases and gross sales to allow the Division to use reported gross sales as the denominator in computing an error rate and that it was proper to project the error rate over the entire audit period to determine the tax due for these expenses. The store cleaning charge was a constant expense totaling $35.00 per week throughout the entire audit period. The parties do not dispute that the snow plowing expenses were, at best, only incurred during six months of each year.

SUMMARY OF THE PARTIES' POSITIONS

7. Petitioner argues that there is no connection between sales and the cost to clean the store or the expense incurred to remove snow and that, absent any relationship between gross sales and the store cleaning and snow plowing expenses, it was improper for the Division to compute an error rate based on gross sales for these two expenses.

With respect to the store cleaning expense, petitioner asserts that there should be a direct accounting for the use tax due on this expense, based on a fixed cost of $35.00 per week, as this

results in an exact determination of the tax due. By using an error rate computed based on reported gross sales, the tax due on store cleaning charges varies with the fluctuation in gross sales. Also, since gross sales for the test period chosen, December 1, 2002 to February 28, 2003, was the third lowest during the audit period and more than $25,000.00 under the quarterly average, the error rate is increased because of the use of a lower denominator, thereby producing a higher tax due for the store cleaning expense than the more accurate direct accounting method.

Turning next to the snow plowing expense, petitioner asserts that this expense should not be projected over the entire audit period since snow plowing occurred for a maximum of only six months a year and not over the entire year.

9. The Division points out that it agreed to perform a second test period audit of purchases for the quarter ending August 31, 2002 and that petitioner supplied purchase invoices for operating expenses only. The Division's review of the limited purchase invoices submitted for this second test period revealed that petitioner made shop supply purchases in the sum of $462.00 and that $138.19 were made tax free. The Division felt that shop supply purchases of only $462.00 were extremely low given the fact that petitioner's gross sales for this quarter totaled $231,466.00. The Division requested to see all purchase invoices for the second test period, including purchases for resale, since experience from prior audits revealed that similarly situated taxpayers typically made purchases of taxable shop supplies and tools tax free from vendors who supply materials for resale. Petitioner believed it to be an onerous and unnecessary task to retrieve the purchase invoices for resale and it therefore declined to do so.

Although it recognizes that snow plowing occurs for only six months a year, the Division decided not to make any adjustment to the assessment since it believes that the assessment is low because (a) the first test period overlooked the fact that no shop supply or tool purchases were

shown and (b) it was unable to review all purchase invoices for the second test period where, in all probability, it would have discovered additional taxable purchases of shop supplies and tools.

CONCLUSIONS OF LAW

A. Tax Law § 1135(a) provides that every vendor required to collect tax must keep adequate records. With respect to purchases, the Commissioner's regulation at 20 NYCRR 533.2(c) states that "[E]very purchaser must maintain documentation to substantiate any exemption, exclusion or exception claimed on the purchase of any tangible personal property or service. The purchase records must provide sufficient detail to independently determine the taxable status of each purchase and the amount of tax due, paid or remitted thereon." Furthermore, regulation 20 NYCRR 533.2(a)(1) provides that to prevent the evasion of tax it is presumed that "all receipts from sales and purchases of property . . . are subject to tax until the contrary is established." The burden of proof to show that a sale or purchase is not taxable is on the taxpayer (20 NYCRR 533.2[a][1]).

B. As relevant to this proceeding, Tax Law § 1138(a)(1) provides as follows:

> If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the commissioner from such information as may be available. If necessary, the tax may be estimated on the basis of external indices, such as stock on hand, purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and services, number of employees, or other factors.

In the instant matter, there is no dispute that petitioner failed to provide all purchase invoices as requested by the Division, thus preventing the Division from verifying that the proper sales tax had been paid on purchases. In this scenario, it must be concluded that petitioner's purchase records were incorrect or insufficient and that the Division could not conduct a detailed audit of purchases from which the exact amount of tax due could be

determined. Accordingly, the Division, pursuant to Tax Law § 1138(a)(1), is permitted to estimate the tax due based on external indices and considerable latitude is given the Division's method of estimating tax due under such circumstances (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219).

C. The assessment at issue herein was based on the Division's audit of partial purchase records for the quarter ending February 28, 2003, and upon completion of this test period it issued a Statement of Proposed Audit Changes for Sales and Use Tax to petitioner, unaware that the first test period did not include any purchases for shop supplies and tools. Only after petitioner protested the Statement of Proposed Audit Changes for Sales and Use Tax and it was decided to conduct a second test period did the Division discover its failure to include expenses for shop supplies and tools in the first test period. Although the Division recognizes the validity of petitioner's arguments with respect to the first test period, it refused to incorporate the results from the second test period or otherwise make any adjustments to the audit on the premise that the assessment is actually understated because of the failure to include shop supplies and tools in both the first and second test periods.

D. In the instant matter, petitioner has sustained its burden of proof to show that the assessment based on the first test period was flawed. Specifically, petitioner is correct that there is no relationship between gross sales and the cost to clean the store or snow plowing expenses.

The use tax due on the store cleaning expense, computed based on a direct accounting basis, is determined to be $32.99 per quarter (13 weeks per quarter x $35.00 per week x 7.25% tax rate). Since the snow plowing expense was incurred for only six months a year, it is appropriate to assess the use tax for this expense only for the quarters ending February 28th and

May 31st. The test quarter found that $1,805.00 was spent on snow plowing,[1] thus producing a tax due of $130.86 ($1,805.00 x 7.25%) and it is determined that this amount is to be assessed for each of the six quarters during the audit period ending February 28th and May 31st.

The expenses for store cleaning and snow plowing are removed from the test period and the error rate, computed as follows, is reduced from .15% to .0588%:

ITEM	**AMOUNT**
Tire disposal expense	$1,131.90
Tool repair expense	302.00
Total expenses	$ 1,433.90
Multiplied by tax rate	x .0725
Tax due	$103.96
Divided by gross sales for test quarter	÷ $176,902.00
Revised error rate	.0588%

E. The Division correctly argues that once petitioner declined to produce all of its purchase invoices, it could have estimated that a certain percentage of purchases were taxable or even held that all of petitioner's purchases were taxable.[2] However, the Division chose not to utilize these permissible audit methods and instead issued the assessment based on a test period which it knew was flawed. The Division's argument that no adjustments should be made to the flawed test period because it believes that the assessment is understated cannot be accepted. The Division's position that the assessment is understated is mere speculation and not supported by

[1] The parties agree that the quarter ending February 28, 2003 was a particularly heavy period for snow and that petitioner incurred a greater expense than usual for snow plowing because of the heavy snowfall.

[2] I suspect that petitioner would have been prompted to produce all purchase invoices for examination had the Division issued an assessment which held all purchases as subject to tax.

any evidence. It could be that petitioner does very little repair work and therefore its purchases of shop supplies and tools were insignificant. The Division's auditor did not visit petitioner's New York location to observe its operation, and while he reviewed sales for the month of April 2003, he did not perform an analysis of sales for this month to determine the extent of petitioner's repair sales. The Division's refusal to make adjustments to a flawed test period because it suspects that there may be additional purchases subject to use tax cannot be sanctioned. The Division had available to it other acceptable audit methods which would have addressed the valid concern that there may have been additional purchases subject to use tax; however, it simply chose not to avail itself of those options. As noted in Conclusion of Law "D," petitioner has sustained it's burden of proof to show that the assessment based on the test period utilized was erroneous with respect to the store cleaning and snow plowing expenses.

F. The petition of Case Tire Service, Inc. is granted to the extent indicated in Conclusion of Law "D"; the Division of Taxation is directed to recompute the Notice of Determination dated December 26, 2003 consistent with this determination and the Conciliation Order dated June 18, 2004; and, except as so granted, the petition is in all other respects denied.

DATED: Troy, New York
March 2, 2006

/s/ James Hoefer
PRESIDING OFFICER