STATE OF NEW YORK

DIVISION OF TAX APPEALS

---

| | | |
|---|---|---|
| In the Matter of the Petition | : | |
| of | : | |
| **VALLEY STREAM BEVERAGES, INC.** | : | DETERMINATION<br>DTA NO. 821117 |
| 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, 1999 through November 30, 2002. | : | |

---

Petitioner, Valley Stream Beverages, Inc., 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, 1999 through November 30, 2002.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on March 14, 2007 at 12:00 PM., with all briefs to be submitted by August 13, 2007, which date commenced the six-month period for the issuance of this determination. Petitioner appeared by Lawrence R. Cole, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Peter B. Ostwald, Esq., of counsel).

## *ISSUES*

I. Whether petitioner had complete books and records, thereby rendering the Division of Taxation's use of a test period audit method improper.

II. Whether, assuming the use of a test period was proper, petitioner has shown error in the audit result by establishing that sales made to Turnpike Beverage, Inc., during the period at issue were sales for resale and thus excluded from sales tax.

III. Whether petitioner has established any facts or circumstances warranting the reduction or abatement of penalties imposed.

## *FINDINGS OF FACT*

1. Petitioner, Valley Stream Beverage, Inc., sold beverages at retail and wholesale. Petitioner sold mostly beer and soda. It also sold ice and miscellaneous items such as iced tea. Petitioner's president and sole shareholder was at all relevant times Michael Fredericks.

2. From 1995 through August 2000, Mr. Fredericks was also the sole shareholder of Turnpike Beverage, Inc. ("Turnpike Beverage"), a similar beverage business, located about two miles from petitioner's business premises. In August 2000, Mr. Fredericks sold all of his shares in Turnpike Beverage to Andrezj Podgorski. Mr. Podgorski continued to operate Turnpike Beverage until May 2002, when he sold the business to VIP, Inc. VIP, Inc., continued to operate the business from the same location and continued to do business as "Turnpike Beverage."

3. On December 10, 2002, the Division of Taxation ("Division") sent a letter to petitioner scheduling an appointment to commence a sales and use tax field audit of petitioner's business for the period December 1, 1999 through November 30, 2002. The Division's letter requested that all of petitioner's books and records pertaining to sales tax liability for that period be available for review. Among the records specifically requested in an attached Records Requested List were the general ledger, cash receipts journal, Federal income tax returns, purchase invoices, sales invoices, bank statements, and exemption documents. By letter dated May 20, 2003, the Division specifically requested that petitioner make available cash register tapes and wholesale

invoices for the audit period, as well as any resale certificates or exemption certificates. Additionally, by letter dated March 17, 2004, the Division requested original wholesale invoices and exemption documents for the quarter ended November 2002 and petitioner's original wholesale daybook. The letter noted that copies of such wholesale invoices and pages from a wholesale daybook for the quarter ended November 2002 had been previously provided.

4. In response to the Division's requests, among other records, petitioner produced monthly summary worksheets, which contained entries for beer, soda, ice, miscellaneous (e.g., iced tea) sales, bottle deposits, bottle returns, checks, charges, and cash. Petitioner did not produce detailed cash register tapes to verify the amounts listed on the monthly worksheets. The cash register tapes that were produced were summary tapes which did not indicate the item being sold. The monthly worksheets also contained entries for wholesale deposits. Petitioner did not ring wholesale sales through the cash register. Petitioner did not produce its wholesale daybook.

5. Petitioner also provided the Division with its sales tax returns and the Division compared gross sales as reported on the sales tax returns with gross sales as listed on the monthly worksheets. This comparison showed that gross sales as listed on the monthly worksheets were greater than gross sales as reported on the sales tax returns. Additionally, taxable sales as listed on the monthly worksheets were greater than taxable sales as reported on the sales tax returns.

6. Based on the lack of detailed cash register tapes, the resulting inability to verify the monthly worksheets, the fact that all sales were not rung through the cash register, and the differences between gross and taxable sales per the monthly worksheets and the sales tax returns, the Division concluded that petitioner's records were inadequate for the purpose of verifying taxable sales and therefore decided to estimate petitioner's sales tax liability for the audit period using a test period methodology.

7. The Division selected the sales tax quarter September 1, 2002 through November 30, 2002 as the test period. As a starting point the Division deemed petitioner's bank deposits and cash payroll as indicated by petitioner's annual W-3 forms (Transmittal of Wage and Tax Statements) to be gross sales.[1] As determined in this manner, petitioner's gross sales for the test period were $240,350.38. From this amount the Division subtracted $117,657.00, petitioner's taxable sales reported during the test period. The resulting difference, $122,693.38, was deemed claimed nontaxable sales. Of this amount, the Division allowed $1,020.81 for sales of nontaxable beverages (e.g., iced tea). Petitioner presented exempt organization certificates and resale certificates with respect to test period sales invoices totaling $68,697.34. Upon review the Division determined that such exemption documentation was insufficient and therefore disallowed exemption with respect to $58,311.99 of such invoices. The Division allowed an exemption with respect to $10,385.35 of such invoices. Petitioner presented no exemption documentation for the remaining $52,975.23 in deemed claimed nontaxable sales; such sales were therefore determined to be taxable. The Division thus disallowed a total of $111,287.22 in claimed nontaxable receipts for the test period. The Division calculated a disallowance rate of 90.70 percent based on the ratio of total disallowed nontaxable receipts to total claimed nontaxable receipts for the test period. The Division then determined petitioner's claimed nontaxable sales for each quarter of the audit period, calculated as previously described (bank deposits plus cash payroll less reported taxable sales), and applied the 90.70 percent disallowance rate to claimed nontaxable sales for each quarter. These calculations resulted in additional taxable sales and, ultimately, additional tax due of $126,025.57 for the audit period.

[1] It is noted that petitioner's bank deposits closely correspond to gross sales as indicated by petitioner's general ledger. Indeed, the Division's workpapers reveal that throughout the audit period petitioner's bank deposits total $3,237,742.73 and sales per the general ledger total $3,231,580.29, a difference of about .2 percent.

8. Of the $68,697.34 in test period receipts for which exemption documentation was submitted, $54,014.00 were receipts for sales to Turnpike Beverage.

9. On November 8, 2004, following the audit, the Division issued to petitioner a Notice of Determination which assessed $126,025.57 in additional tax due, plus interest and penalties, for the period December 1, 1999 through November 30, 2002. The penalties assessed in the notice were imposed pursuant to Tax Law §1145(a)(1)(i) and (vi) (an omission of an amount greater than 25 percent of the tax due).

10. Following a conciliation conference, the Division's Bureau of Conciliation and Mediation Services issued a Conciliation Order dated March 3, 2006 which reduced the assessment at issue to $81,482.91, plus penalties and interest. The reduction results from the use of lower rates of disallowance for claimed nontaxable sales. For the period December 1, 1999 through February 28, 2002, the Division used a rate of disallowance of 70.26 percent to calculate additional taxable sales. Several factors contributed to this lower disallowance rate. First, the test period starting point of gross sales, determined as previously noted, was reduced by $36,000.00 because of a recalculation (and correction) of the cash payroll for the three-month test period. Second, claimed nontaxable sales for the test period were reduced by allowances for bottle deposits and cigarette taxes. Third, a sale of $601.60 to an exempt organization, previously disallowed, was allowed. All of the sales to Turnpike Beverage remained disallowed. For the period March 1, 2002 through November 30, 2002, the Division used a rate of disallowance of 14.40 percent. In addition to the factors noted above, this disallowance rate resulted from the allowance of sales to Turnpike Beverage as nontaxable sales for resale.

11. During the course of the audit, on June 16, 2003, petitioner presented the Division with two resale certificates (Form ST-120) listing petitioner as the seller and Turnpike Beverage

as the purchaser. These certificates were incomplete as neither was dated, neither indicated whether it was a single-use or blanket certificate as required on the form, and neither contained information describing the business of the purchaser as required on the form. Both did list a sales tax certificate of authority number for Turnpike Beverage and both purport to bear the signature of Mr. Podgorski as president of Turnpike Beverage.

12. Later during the audit, on or about August 2, 2004, petitioner provided the Division with additional resale certificates with respect to Turnpike Beverage. Specifically, petitioner provided a completed blanket resale certificate with a handwritten date of June 16, 2000 indicating purchases for resale by Turnpike Beverage from petitioner. This certificate was signed by Mr. Podgorski and had the certificate of authority number and the business information regarding Turnpike Beverage. Also at that time petitioner provided a completed blanket resale certificate dated May 5, 2002 listing petitioner as the seller and VIP, Inc., as the purchaser.

13. Still later, on August 19, 2004, petitioner provided an additional completed blanket resale certificate with a handwritten date of July 1, 2004, listing petitioner as the seller and Turnpike Beverage as the purchaser.

14. Petitioner regularly made sales to Turnpike Beverage throughout the audit period. Petitioner's owner, Mr. Fredericks, made these sales to save on costs, as he could get a better price from suppliers by purchasing in greater volume. Mr. Fredericks started this practice when he owned both petitioner and Turnpike Beverage and continued it when Mr. Podgorski owned Turnpike Beverage, and later when VIP, Inc., owned the business (***see***, Finding of Fact "2"). It was a simple matter to load Turnpike Beverage's purchases in a van for the short five-minute ride to Turnpike Beverage.

15. A review of the invoices reflecting the $54,014.00 in purchases during the test period made by VIP, Inc., doing business as Turnpike Beverage, shows 20 separate purchases during the three-month period in amounts ranging from $1,493.91 to $5,111.69. The purchases are almost all beer, mostly in large quantities. Typical of such purchases is an invoice dated September 3, 2002 which totaled $3,611.85. Among the items listed on this invoice are 75 Budweiser 30-packs, 70 Coors Light 30-packs, 25 Busch 30-packs, 16 Budweiser 12-packs, 12 Michelob Light 12-packs, 10 Bud Light 30-packs, 10 Bud Ice 30-packs, 10 Budweiser 18-packs, and smaller quantities of several other brands of beer.

16. Petitioner was previously audited by the Division for the period December 1, 1994 through May 31, 1999. During that audit the Division determined that petitioner's sales tax records were inadequate because cash register tapes did not indicate the item being sold. This audit resulted in an agreed assessment of $22,203.00 in additional sales tax due. During the period of the prior audit petitioner made significant sales to Turnpike Beverage which it claimed were exempt from sales tax as sales for resale. The Division accepted such claimed nontaxable status in the prior audit. The audit report indicates that, in the prior audit, wholesale sales were tested and allowed.

17. Although, as noted, Mr. Fredericks sold all of his shares in Turnpike Beverage to Andrezj Podgorski in August 2000, and Mr. Podgorski operated Turnpike Beverage until May 2002, Mr. Fredericks remained the owner associated with Turnpike Beverage's sales tax identification number on the Division's records until Turnpike Beverage, Inc., filed its final return in May 2002.

18. Petitioner's reported taxable sales for the audit period totaled $1,591,971.00. The modified assessment, adjusted pursuant to the Conciliation Order dated March 3, 2006, asserts

$958,622.32 in additional taxable (or disallowed nontaxable) sales. Hence, penalties under Tax Law §1145(a)(1)(vi) for an omission of an amount greater than 25 percent of the tax due remain applicable.

## *CONCLUSIONS OF LAW*

A. Petitioner asserts that it maintained complete and accurate records and that therefore the Division's use of a test period audit method was improper. This assertion is rejected. The cash register tapes produced by petitioner were not detailed. The Division could not, therefore, verify sales as recorded on the monthly worksheets. Additionally, petitioner did not ring wholesale sales through the cash register; thus the tapes could not verify petitioner's claimed nontaxable sales or claimed gross sales. Also, petitioner did not produce its daybook for wholesale sales as requested. Further, the discrepancy between petitioner's sales tax returns and monthly worksheets raises questions as to the accuracy of petitioner's records. Under such circumstances, petitioner's records were inadequate for the purpose of conducting an audit to determine the accuracy of petitioner's sales tax returns as filed (***see***, ***Matter of Family Deli of Bellmore, Inc.***, Tax Appeals Tribunal, April 3, 1997). Accordingly, the Division was authorized to use an estimated audit method, so long as such method was reasonably calculated to reflect the taxes due (***see***, ***Matter of Ristorante Puglia, Ltd. v. Chu***, 102 AD2d 348, 478 NYS2d 91, 93). The test period is well established as an acceptable audit method (***see***, ***e.g.***, ***Matter of Continental Arms Corp. v. State Tax Commn.***, 72 NY2d 976, 534 NYS2d 362).

B. Where, as in the instant matter, resort to a test period audit is appropriate, 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). Here, petitioner contends that the audit result is

erroneous because the Division improperly disallowed claimed nontaxable sales to Turnpike Beverage.

Tax Law § 1105(a) imposes a sales tax on the receipts from "every retail sale" of tangible personal property. Tax Law § 1101(b)(4)(I) defines a retail sale as a sale for any purpose "other than . . . for resale as such." Tax Law § 1132(c) sets forth a presumption that all sales receipts are subject to tax "until the contrary is established," and sets the burden of proving the contrary upon the sales tax vendor.

The presumption of taxability created under Tax Law § 1132(c) is not irrebuttable (***see***, ***Matter of RAC Corp. v. Gallman***, 39 AD2d 57, 331 NYS2d 945). Accordingly, where, as here, a vendor fails to obtain a timely or properly completed resale certificate, such failure does not change the tax status of the transaction and such taxpayer retains the right to prove that such sale was nontaxable (***see***, 20 NYCRR 532.4[b][6]). The failure to obtain a timely and properly completed resale certificate merely deprives the vendor of the right to rely solely on the resale certificate to meet its burden (***id.***). Thus, the specific question in this case becomes whether, in light of all the facts and circumstances, petitioner has provided sufficient evidence to establish its sales to Turnpike Beverage during the period December 1, 1999 through February 28, 2002 were sales for resale and therefore not subject to tax (***see***, ***Matter of Intercontinental Audio & Video, Inc.***, Tax Appeals Tribunal, January 4, 1996).

C. Considering all of the evidence presented, it is concluded that petitioner has carried its burden of proving that the sales to Turnpike Beverage were, in fact, wholesale sales. First, the volume of beverages sold by petitioner to Turnpike Beverage (***see***, Finding of Fact "15"), a similar beverage business, gives rise to the reasonable inference that Turnpike Beverage was not the end user (i.e., retail purchaser) of such goods, but that Turnpike in fact resold such beverages

to consumers. While such an inference, by itself, may be insufficient to carry petitioner's burden (***see***, ***Matter of Savemart v. State Tax Commn.***, 105 AD2d 1001, 482 NYS2d 150, ***lv denied*** 65 NY2d 604, 493 NYS2d 1025), additional evidence in the record is sufficient, viewed as a whole, to meet petitioner's burden. Specifically, the credible testimony of Mr. Fredericks established that petitioner regularly sold product to Turnpike Beverage in order to save on costs and that petitioner had been making such sales to Turnpike Beverage during the period that he owned both businesses, later when Mr. Podgorski owned Turnpike Beverage and still later when VIP, Inc., owned the business. Furthermore, by its allowance of sales to VIP, Inc., doing business as Turnpike Beverage, during the test period, the Division itself has conceded that petitioner regularly made wholesale sales to Turnpike Beverage. It is illogical to allow such sales for the period that Turnpike Beverage was owned by VIP, Inc., and to disallow similar sales during the time Turnpike Beverage was owned by Mr. Podgorski and Mr. Fredericks. Additionally, although flawed to the extent that such documents are incomplete or not timely received, the record does contain copies of resale certificates evidencing sales for resale from petitioner to Turnpike Beverage (***see***, Findings of Fact "11"-"13").

Accordingly, the Division is directed to adjust the subject assessment, as modified by the Conciliation Order dated March 3, 2006, by applying the 14.40 percent rate of disallowance to claimed nontaxable sales for the period December 1, 1999 through February 28, 2002.

D. The Division argues that petitioner's submission of incomplete and untimely resale certificates is sufficient to justify the denial of nontaxable status for the sales to Turnpike Beverage. This contention runs contrary to the Division's own regulations which, as noted previously, provide that the failure to produce proper documentation does not change the tax status of the transaction (***see***, 20 NYCRR 532.4[b][6]).

The Division also cites to the fact that the sales tax identification numbers for both petitioner and Turnpike Beverage were associated with Mr. Fredericks as supportive of its position. Inasmuch as Mr. Fredericks owned both petitioner and Turnpike Beverage from 1995 until August 2000, his name would properly be associated with both corporations during that time. That the Division's records were not changed to reflect Mr. Podgorski's purchase of Turnpike Beverage has no impact on the tax status of the sales at issue.

The Division further suggests that the transactions between petitioner and Turnpike Beverage appear to be merely the transfer of inventory between affiliated businesses. As to this contention, it is noted that from August 2000 forward, Turnpike Beverage was owned by Mr. Podgorski (and later VIP, Inc.) and thus there was no common ownership and no affiliation between petitioner and Turnpike Beverage. As to the period December 1999 through August 2000, the fact that there was common ownership of the businesses has no impact on the tax status of the sales at issue. As discussed previously, petitioner has established that the sales to Turnpike Beverage were sales for resale.

Also in support of its position the Division referred to the transactions between petitioner and Turnpike Beverage as "less than arm's length." There is no evidence in the record to support this characterization of the transactions at issue.

E. 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 "shall" be subject to a penalty. This penalty may be canceled if the failure was "due to reasonable cause and not due to willful neglect" (Tax Law § 1145[a][1][iii]). Consistent with this statute, the Division'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]).

Petitioner argues for abatement of penalty based on claimed adequate records and a lack of any significant underreporting. As to this argument, this determination has concluded that petitioner did not have adequate records (***see***, Conclusion of Law "A") and, while this determination has determined that the sales to Turnpike Beverage were nontaxable, petitioner has offered no explanation for its failure to report and pay over the tax which remains due. Accordingly, penalty imposed under Tax Law § 1145(a)(1)(i) is sustained.

F. 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, following the adjustment set forth in Conclusion of Law "C," it is clear that the 25 percent penalty is no longer applicable to the instant matter. Accordingly, penalty imposed pursuant to Tax Law § 1145(a)(1)(vi) is cancelled.

G. The petition of Valley Stream Beverages, Inc. is granted to the extent indicated in Conclusions of Law "C" and "F." In accordance therewith, the Division of Taxation is directed to adjust the Notice of Determination dated November 8, 2004, as modified pursuant to the Conciliation Order dated March 3, 2006. The petition is in all other respects denied. As so modified, the subject assessment is sustained.

DATED: Troy, New York
November 8, 2007

/s/ Timothy J. Alston
ADMINISTRATIVE LAW JUDGE