

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ISLAND COSMETICS CENTER, INC.	:	
A/K/A 3 ROADS COSMETICS	:	
for Revision of a Determination or for Refund of Sales	:	DETERMINATION
and Use Taxes under Articles 28 and 29 of the Tax Law	:	DTA NO. 821733
for the Period December 1, 2001 through November 30,	:	
2004.	:	

Petitioner, Island Cosmetics Center, Inc. a/k/a 3 Roads Cosmetics, 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, 2001 through November 30, 2004.

A hearing was commenced before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on March 18, 2008 at 10:30 A.M., was continued at the same location on May 8, 2008 at 10:00 A.M. and was concluded at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 4, 2008 at 10:30 A.M., with all briefs to be submitted by February 9, 2009, which date began the six-month period for the issuance of this determination. Petitioner appeared by Bruce P. Vetri, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUES

I. Whether the books and records provided by petitioner to the Division of Taxation pursuant to requests therefor were sufficient for the performance of a detailed audit.

II. If not, whether petitioner has sustained its burden of proving that the audit method employed by the Division of Taxation was unreasonable or that the amount of tax assessed against petitioner was erroneous.

III. Whether penalties assessed against petitioner should be abated.

FINDINGS OF FACT

1. On October 27, 2004, the Division (Division) sent a letter to Island Cosmetics Center, Inc. (petitioner) which scheduled a field audit of petitioner's business for November 23, 2004. The audit period indicated on the letter was December 1, 2001 through August 31, 2004. Attached to the letter was a Records Requested List which instructed petitioner to provide the following books and records for the audit period: sales tax returns, worksheets and canceled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; exemption documents; chart of accounts; fixed asset purchase and sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips; cash receipts journal; cash disbursements journal; the corporate book; and depreciation schedules.

The audit appointment was subsequently rescheduled for January 20, 2005 and another letter (and Records Requested List) was sent on December 27, 2004 to petitioner's former representative, Kaplan Management Consultants, Inc.

Upon learning that petitioner had filed a final sales tax return, the audit period was amended to December 1, 2001 through November 30, 2004. A letter dated April 13, 2005 was sent to petitioner's representative to inform it of the amended audit period and a Records Requested List to include the amended period was attached.

2. Petitioner operated beauty supplies stores in Port Jefferson, New York, and in Shirley, New York, during the period at issue. Although it operated from these two locations, petitioner's sales tax returns listed only the Port Jefferson address.

3. On January 12, 2005, April 8, 2005, October 19, 2005 and February 2, 2006, the Division and petitioner executed consents whereby the statute of limitations for the assessment of sales and use taxes was extended to any time on or before June 20, 2006.

4. On January 20, 2005, at the offices of petitioner's representative, the auditor was presented with incomplete general ledgers, some bank statements and federal income tax returns. There were no cash register tapes, sales invoices or source documents to substantiate sales. Some purchase records were provided, but the auditor could not determine whether these records included all of petitioner's suppliers. The auditor, therefore, presented petitioner's representative with a list of records still needed to complete the audit. During the months of February and March 2005, additional conversations with petitioner's representative were held to request books and records which had not been made available. On March 17, 2005, the auditor discussed with petitioner's representative her intention to subpoena petitioner's bank records, and on April 14, 2005, subpoenas were issued.

5. As previously noted, upon learning that petitioner had filed a final return, the audit period was updated to December 1, 2001 through November 30, 2004. After the filing of the final sales tax return, petitioner's owner, Dennis D'Amato, immediately started a new corporate business, known as Beauty Plus Stores, at the same Port Jefferson address. When Mr. D'Amato was notified that Beauty Plus Stores was going to be audited, that business was discontinued and still another corporation was formed, which again operated out of the same Port Jefferson location. That business was known as Ultimate Cosmetics.

6. Since the auditor determined that the books and records provided by petitioner were inadequate for the performance of a detailed audit, she resorted to an indirect method which consisted of a bank deposit analysis. Deposits from Chase Manhattan Bank, Washington Mutual (two accounts), Suffolk National Bank and HSBC Bank were analyzed.¹ Deposits for the audit period totaled \$5,896,795.26. The auditor deducted returned checks (\$21,762.05), loans (\$15,757.26) and transfers between accounts (\$506,629.66) to arrive at deposits of \$5,352,646.29.

During one of the auditor's meetings with petitioner's representative, a document (a worksheet from one of the sales tax returns) was submitted which indicated that petitioner had a cash payroll. This money was not deposited into the bank. Since the worksheet showed a cash payroll of \$28,548.00 for one quarter, this amount was projected for the entire audit period to arrive at total cash payroll of \$323,544.00, which was added to the deposits, thereby resulting in total deposits of \$5,676,190.29. Sales tax reported on each of the sales tax returns for the audit period (a total of \$167,779.89) was deducted, leaving a balance of \$5,508,410.40. Credit was given for taxable sales reported for the audit period (\$1,948,570.00), which resulted in audited taxable sales of \$3,559,840.40.

Tax due thereon (computed at 8.5% for the period December 1, 2001 through May 31, 2003 and at 8.75% for the period June 1, 2003 through November 30, 2004) was found to be \$305,795.89.

The auditor also reviewed fixed asset acquisitions from petitioner's federal income tax returns and general ledger for the audit period. Since petitioner was unable to produce invoices

¹ Since the auditor was unable to obtain statements from Chase Manhattan Bank to verify deposit activity, amounts recorded in petitioner's general ledger were utilized.

to show that sales tax had been paid on any of these fixed asset acquisitions, tax was assessed on the total thereof, or \$10,673.23. Therefore, total additional tax due was determined to be \$316,469.12.

7. During the audit, petitioner's representative provided the auditor with a number of documents in an attempt to show that it made substantial sales for resale and also made a large number of exempt sales. These documents included purchase orders from Rome Associates, Inc. (Rome) of Bohemia, New York, and from Hinds Feet, Inc. (Hinds Feet) of Medford, New York, entities to which petitioner claimed that it had made wholesale sales for resale.

A blanket Resale Certificate issued June 27, 2005 from Rome to petitioner was provided. Purchase orders indicating that Rome had purchased various products in 2003 from "Three Roads" and from "G Damato" were supplied to the auditor along with copies of checks from petitioner to Rome during various months of 2003.

A Resale Certificate (undated) from Hinds Feet to petitioner was provided to the auditor. The certificate was signed by David Kohen, President. In addition, a letter from Hinds Feet dated August 29, 2005 was given to the auditor which stated as follows: "We hereby certify that Hinds Feet, Inc. has bought merchandise from Island Cosmetics from January 2003 until the present time." The letter, while unsigned, was from David Cohen, President. It must be noted that the Resale Certificate spelled the president's name "Kohen" while the letter spelled his name "Cohen." Along with these documents were a large number of purchase orders from December 2002 through December 2003 which indicated that Hinds Feet purchased various products from petitioner.

Petitioner also provided the auditor with a number of exempt organization and exempt use certificates issued by a number of allegedly exempt organizations. No invoices were attached to these certificates.

Finally, petitioner provided invoices from Tri State Beauty Systems, Inc., which indicated sales to "Salon Three - Pt Jeff" during 2003 (19 pages), sales to "Salon Three 05/06" during 2004 (14 pages), sales during 2003 to "Salon Three - Shirley"(19 pages) and to "Salon Three - Shirley"(8 pages) during 2004.

8. The auditor indicated that the purchase orders for alleged wholesale sales by petitioner were not accepted by the Division because they appeared to have been printed from a computerized program (QuickBooks) by petitioner, were not sales invoices and were not accompanied by checks or any other proof of payment from Rome or Hinds Feet. In addition, the auditor stated that due to the lack of proof of payment by Rome and Hinds Feet, there was no proof that the amounts set forth on the purchase orders were ever deposited into petitioner's bank accounts. Accordingly, the auditor gave petitioner no credit for the wholesale business (sales to Hinds Feet and Rome) which petitioner claimed during the audit period.

Petitioner did provide to the auditor copies of its checks made payable to "Rome" or "Rome Dist." during the period March through July 2003. These checks totaled \$23,419.42.

9. On April 26, 2006, the Division issued a Statement of Proposed Audit Change for Sales and Use Tax to petitioner in the amount of \$316,469.12, plus penalties and interest, for a total amount due of \$606,048.62 for the period December 1, 2001 through November 30, 2004.

10. Thereafter, on June 9, 2006, the Division issued a Notice of Determination to petitioner which assessed additional sales and use taxes of \$316,469.12, plus penalties and

interest, for a total amount due of \$610,299.58 for the period December 1, 2001 through November 30, 2004.

11. Penalties were assessed (including the omnibus penalty for omission of in excess of 25% of the tax required to be shown on the return) because petitioner did not report all of the sales from the deposits made and because a taxable ratio of approximately 50% was claimed for each quarter. For the first six quarters at issue, petitioner's taxable ratio was exactly 49.96%. For the next two quarters, the taxable ratio was 52.91%, which variation the auditor attributed to the increase in the sales tax rate from 8.5% to 8.75%.

12. The auditor visited petitioner's Port Jefferson store during the audit, but did not visit the Shirley store. He learned of the existence of the Shirley store only during the later stages of the audit. The auditor walked up and down the aisles of the Port Jefferson store and saw no items which appeared to be nontaxable.

13. When the auditor visited the Port Jefferson store, he saw eight to ten salon chairs, but did not see anyone stationed at these chairs. During the audit, the auditor was not shown any proof that rent was paid to or collected by petitioner. In addition, on petitioner's federal income tax returns, no rental income was listed. While one of petitioner's representatives produced a listing of hairdressers (the list did not include addresses or social security numbers of the hairdressers) each of whom allegedly paid rent in the amount of \$150.00 per week, no documentation such as checks, written agreements, etc., was produced to substantiate petitioner's claim that the rent was paid.

The auditor was informed by petitioner's representatives that the salon was set up so Mr. D'Amato could buy certain "high end" salon products which were sold only to salons and not to

retail stores. He was also informed that petitioner did not use most of these products but, instead, resold them to certain vendors such as Hinds Feet and Rome.

14. Dennis D'Amato, who stated that he was the owner of petitioner, appeared at the hearing held in this matter. The Port Jefferson store sold beauty and hair supplies and health and beauty aids. The salon was created so that petitioner could sell products which other stores could not. Mr. D'Amato stated that the "high end" products are very popular with "street peddlers," who bought the products from retailers and then sold them to other retail stores. Vendors such as Hinds Feet and Rome were examples of what Mr. D'Amato referred to as "street peddlers." These vendors, who sell out of their trucks, sell to drugstores and independent discount stores, products found only in salons. Mr. D'Amato claimed that he had 9 salon chairs in his Port Jefferson store and 11 chairs in the Shirley store, which opened in 1991 and was smaller than the Port Jefferson store. He claimed that Hinds Feet and Rome paid him in cash (he would not accept their checks) for the products sold by petitioner and further claimed that for the period at issue, petitioner's sales to Hinds Feet were approximately \$600,000.00 while sales to Rome were approximately \$700,000.00. Mr. D'Amato produced the purchase orders on his computer from a program known as QuickBooks. Mr. D'Amato stated that these purchase orders were evidence of petitioner's sales and were, in essence, his sales invoices.

Mr. D'Amato stated that he did not make Hinds Feet or Rome pay the entire amount due to petitioner at the time of the sale of the hair and beauty products, but required them to pay at least a portion of the balance due upon pickup of the merchandise.

15. In December 2005, petitioner was evicted from the Shirley location for nonpayment of rent. The landlord locked Mr. D'Amato out of the store where he claims that most of the books and records for both stores were located. As a result, petitioner is unable to prove from whom it

purchased the inventory sold in the two stores and also resold to the peddlers. Mr. D'Amato estimated that 30 to 35% of his business was wholesale business and that approximately 50% of his business (wholesale plus sale of nontaxable items) was not subject to tax.

16. Mr. D'Amato changed the name of the business to Beauty Plus Stores because the Island Cosmetics checks were "bouncing" and later changed the name of the business to Ultimate Cosmetics. He indicated that the cosmetics companies would not sell their products to him without the name "cosmetics" in the company name. He admitted that he was told that Beauty Plus Stores was going to be audited, but stated that the audit was not the reason for the name change.

17. Mr. D'Amato stated that all of the cash received by the business was deposited each day. However, while he asserts the foregoing, he admitted, during cross examination, that he paid his employees in cash. During some of the sales tax quarters at issue, no cash payroll was shown on the sales tax worksheets. Mr. D'Amato stated that during some periods, "when we get quiet we have to send some people home." Other than his wife, his daughter and himself, there were no other employees during these periods. He indicated that "when things were bad my family members worked for me and they didn't get paid." However, he admitted that he was paid in cash. When asked, during cross examination, to explain why his own salary was not reflected in cash payroll on petitioner's federal income tax returns, he replied, "I can't."

For the sales tax quarter ended November 30, 2002, gross sales, as set forth on petitioner's sales tax return, were \$376,000.00 and cash payroll was shown to be \$28,548.00 for this quarter. For the sales tax quarter ended February 28, 2003, gross sales were reported to be \$399,000.00, yet no cash payroll was shown for this quarter.

18. Mr. D'Amato stated that petitioner occasionally purchased products from Hinds Feet, Rome and other peddlers because, at times, they could obtain the products at a lower price.

19. David Cohen, who owned 50% of Hinds Feet during the period at issue, appeared and testified on behalf of petitioner. He stated that Dennis D'Amato wholesaled him hair care products and that he paid, in cash, "on a rolling basis." Mr. Cohen indicated that during the audit period, he purchased approximately \$600,000.00 worth of products from petitioner.

Mr. Cohen gave Mr. D'Amato a list of the products he needed and then received a purchase order from petitioner. None of the purchase orders indicated how much Hinds Feet was paying each time it picked up products, nor did the purchase orders indicate how much Hinds Feet still owed to petitioner. Mr. Cohen stated: "I always knew, actually, in my own head because he's the only one I owed money to." According to Mr. Cohen, Hinds Feet ordered product from petitioner at least on a weekly basis. His average running balance with petitioner was approximately \$3,000.00 to \$5,000.00 and Mr. Cohen made payments several times per week.

Mr. Cohen provided the information to his accountant to prepare Hinds Feet's tax returns and indicated that the business's cost of goods sold was derived from its bank statements. Hinds Feet purchased goods from approximately 50 suppliers; they were paid by check, wire transfer or cash.

20. Introduced into evidence at the hearing were the 2003 and 2004 federal income tax returns of David Cohen and his late wife, Valerie Vellucci. Also introduced into evidence were the federal income tax returns for the S Corporation, Hinds Feet, Inc., for 2003 and 2004 and schedules K-1 issued by Hinds Feet to David Cohen for such years.

David Cohen stated that for the year 2003, his salary from Hinds Feet was \$465,000.00. Mr. Cohen's federal income tax return for 2003 indicated wages (for both him and his wife) of \$74,575.00.

David Cohen stated that Hinds Feet employed four people in addition to his wife and himself and that checks for payment of wages were issued to these employees. Mr. Cohen further stated that taxes were withheld from the wages of the employees and that withholding tax returns were filed by Hinds Feet. However, on the 2003 U.S. Income Tax Return for Hinds Feet, on line 8 thereof, no salaries and wages were listed.

Hinds Feet is no longer in business. Mr. Cohen lost the business in 2006 after the death of his wife.

21. On the third and final day of the hearing held in this matter, petitioner produced and offered into evidence a number of canceled checks issued by petitioner to various suppliers. These checks, drawn on several different accounts, were as follows:

- a. checks issued in 2002 totaling \$68,685.00 to DePasquale for hair care products which Dennis D'Amato stated were wholesaled to peddlers and upon which no sales tax was collected;
- b. checks issued in 2002 to Paramount, a beauty products distributor, totaling \$173,611.00 which Dennis D'Amato stated were wholesaled to peddlers and upon which no sales tax was collected;
- c. checks issued in 2002 to a number of smaller distributors such as BPI, One Way and United Beauty totaling \$53,237.00 for products which were wholesaled by petitioner and upon which no sales tax was collected;
- d. checks issued in 2003 to a number of suppliers totaling \$185,970.00 for products which were wholesaled by petitioner and upon which no sales tax was collected;

e. checks issued in 2002 to a number of suppliers totaling \$297,839.00 which Mr. D'Amato stated were for nontaxable items such as vitamins and headache and pain relievers;

f. checks issued in 2003 to a number of suppliers totaling \$209,466.00 which Mr. D'Amato again stated were for nontaxable items; and

g. credit card statements for the years 2002 through 2004 for purchases made by Dennis D'Amato for items which he stated were nontaxable and wholesale items. These purchases were made using his personal credit card in order to obtain points, mileage, etc., given to purchasers by credit card companies. These purchase totaled \$375,987.00 during the years 2002 through 2004. Mr. D'Amato stated that 95% of these items purchased on his credit card were sold as either nontaxable or wholesale items.

22. No checks issued by petitioner in 2004 were produced because Mr. D'Amato stated that the checks were in the Shirley store, and he was locked out and denied access when evicted in December 2005. The audit of petitioner was commenced in October 2004 when the first of several requests for records was made by the Division, and the initial meeting of the auditor with petitioner's representative occurred in January 2005, roughly one year prior to the time when petitioner was allegedly denied access to the Shirley store where petitioner's checks were stored.

SUMMARY OF PETITIONER'S POSITION

23. Petitioner contends:

a. Approximately 25% of the sales at the Port Jefferson store were sales of nontaxable items such as suntan lotions, vitamins, headache and pain medicine and medicated shampoos. As to the Shirley store, approximately 60% of the sales were sales of nontaxable items. In addition, numerous sales were made to exempt organizations;

b. Approximately 30 to 40% of petitioner's sales were to street peddlers such as Hinds Feet and Rome. During the years at issue, sales to Hinds Feet totaled approximately \$600,000.00 while sales to Rome totaled approximately \$700,000.00; and

c. Petitioner's bank deposits included rent collected from hairdressers who rented salon chairs at the back of petitioner's stores and such monies were, therefore, not sales upon which sales tax would have been collected;

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "[a] sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices" (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.*, as follows:

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, [102 AD2d 352, 477 NYS2d 858]) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521

NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is “virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit” (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), “from which the exact amount of tax due can be determined” (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, “[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case” (*Matter of Grecian Sq. v. Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

C. By letters dated October 27, 2004, December 27, 2004 and April 13, 2005, the auditor made written requests for the books and records of petitioner. He was provided with incomplete general ledgers, some bank statements and federal income tax returns. Later the auditor was provided with purchase orders which petitioner’s owner, Dennis D’Amato, contended were the same as sales invoices. No cash register tapes, sales invoices or other source documentation was provided from which the auditor could accurately determine petitioner’s sales for the audit period. Accordingly, the auditor properly determined that the records presented were

insufficient to perform a detailed audit of petitioner and an indirect audit method, a bank deposit analysis, was performed.

D. Having found that the Division properly resorted to external indices to estimate tax due, it must be determined whether the audit method utilized, i.e., a bank deposit analysis, was reasonably calculated to reflect tax due. As previously noted, petitioner bears the burden of proving, with clear and convincing evidence, that the resulting assessment is erroneous or that the audit methodology was unreasonable.

A bank deposit analysis has been used by the Division in numerous sales tax audits and such an analysis has been found to be a reasonable audit method (*see Matter of MacLeod*, Tax Appeals Tribunal, July 3, 2008; *Matter of D&V Liquors*, Tax Appeals Tribunal, March 10, 2005).

Petitioner provided no records of its sales to the Division. In addition, its witnesses, most notably Dennis D'Amato, petitioner's owner, and David Cohen, 50% owner of Hinds Feet, offered less than credible testimony concerning petitioner's business operation.

Mr. D'Amato contended that petitioner sold approximately \$1,300,000.00 worth of beauty care products to Hinds Feet and Rome during the audit period. Yet, petitioner has no sales invoices and no record of any payments made by Hinds Feet and Rome for their alleged purchases. Mr. D'Amato's assertion that these vendors paid strictly in cash because he would not accept their checks (yet petitioner apparently purchased substantial amounts of product from Rome by check [*see* Finding of Fact 8]), but that he allowed them to pay, in cash, on a rolling basis, with no written record of amounts paid and still owing, is, to say the least, incredible.

In addition, as correctly opined by the Division in its brief,² “Mr. D’Amato’s explanation of why petitioner, a retailer, sold products to wholesale distributors is illogical.” Mr. D’Amato testified that suppliers of these high-end hair and beauty products would sell only to hair salons in order to control the distribution of their products. For this reason, he purportedly rented chairs to hairdressers in his two locations so that he could buy these products. While these suppliers were aware that petitioner resold products to the street peddlers (wholesalers), Mr. D’Amato stated that they did not care since this practice resulted in greater sales by the suppliers. Clearly, if the purpose of requiring a purchaser of the hair and beauty products to be a salon was to control the distribution of the products, there would be no reason for them to sell such large quantities to petitioner, knowing that petitioner was reselling to wholesalers who were selling to retail stores such as drugstores and independent discount stores.

But, of greater import herein, petitioner has wholly failed to prove the amount of its purchases as well as the amount of its retail and alleged wholesale sales. In addition, petitioner has shown no entitlement to any adjustments in the assessment of the Division. Mr. D’Amato testified that the bank deposits included rent collected from hairdressers who rented chairs in petitioner’s stores. However, there has been no proof offered to show that any rents were paid to petitioner. While petitioner offered resale certificates from Hinds Feet and Rome and exempt organization and exempt use certificates issued by a number of allegedly exempt organizations, no sales invoices or proof of payment were attached to these certificates to substantiate the dates and amounts of sales by petitioner.

² Despite reserving time to do so, petitioner did not submit a brief or a reply to the Division’s brief.

E. The testimony of Thomas DeSensi, a tax consultant, who testified on behalf of petitioner was of little or no value in this proceeding. While he speculated as to the correct amount of tax due and owing by petitioner, Mr. DeSensi possessed no documentation to substantiate his contentions. His testimony was merely an attempt to corroborate Mr. D'Amato's statements concerning rent received from hairdressers, the validity of petitioner's purchase invoices (with no proof of payment by purchasers) and petitioner's exempt sales and resales. Accordingly, no weight was given to Mr. DeSensi's testimony.

F. David Cohen's testimony on behalf of petitioner lacked any degree of credibility. He testified that during the audit period, he purchased, on behalf of Hinds Feet, more than \$700,000.00 worth of beauty products from petitioner. The only evidence of these purchases, he claimed, were the purchase orders prepared by Dennis D'Amato which showed thereon no payments made or balance owed. Mr. Cohen stated that all payments to petitioner were made in cash and that he kept the running balance in his head.

Mr. Cohen testified that his business made a profit of approximately 20% on goods sold by Hinds Feet, yet his tax returns indicated a much lower profit percentage. As indicated in Finding of Fact 20, Mr. Cohen stated that his 2003 wages from Hinds Feet was \$465,000.00, yet his federal income tax return for the 2003 tax year indicated that the total wage income for Mr. Cohen and his wife was \$74,575.00. While he claimed that Hinds Feet had employees and that withholding tax returns were filed by Hinds Feet for these employees, the 2003 U.S. Income Tax Return for the company showed no payments of salaries or wages.

G. In summary, the testimony of all witnesses on behalf of petitioner, i.e., Dennis D'Amato, Thomas DeSensi and David Cohen, cannot be found to be credible. The documentation produced by petitioner, most notably the purchase invoices and canceled checks

drawn on various accounts of petitioner, do not in any way substantiate that petitioner made wholesale sales and exempt sales which would warrant an adjustment to the assessment of the Division. As noted herein, no sales invoices or related documents were attached to the resale certificates from Hinds Feet and Rome or to the exempt organization certificates to substantiate petitioner's contentions that sales for resale or exempt sales were made by petitioner during the audit period. Without sales invoices, receipts or canceled checks from the wholesalers and exempt organizations, there can be no evidentiary basis for adjustments to the assessment at issue herein.

In addition, absent any proof of payment by hairdressers or receipt of rent by petitioner for the use of salon chairs at the Port Jefferson and Shirley store locations, petitioner has wholly failed to substantiate its allegation that any portion of its bank deposits was derived from rental income.

H. Finally, petitioner contends that penalties assessed herein should be abated. In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). Petitioner herein has produced no credible evidence to explain its failure to properly report and pay the correct amounts of tax due and owing on its sales. In addition, it failed to maintain and produce on audit, books and records to substantiate its purchases and sales. As noted by the Tax Appeals Tribunal on a number of occasions, the failure to maintain and provide records is, in and of itself, a reason to sustain the imposition of penalties (*Matter of Rosemellia*, Tax Appeals Tribunal, March 12, 1992; *see also Matter of Shukry v. Tax Appeals Tribunal*, 184 AD2d 874, 585 NYS2d 531[1992]). Penalties are, therefore, sustained.

I. The petition of Island Cosmetics Center, Inc. a/k/a 3 Roads Cosmetics is denied and the Notice of Determination issued by the Division on June 9, 2006 is sustained in its entirety.

DATED: Troy, New York
July 23, 2009

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE