

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>REGISTER AND GRILL MANUFACTURING CO.,</b>	:	DETERMINATION
<b>INC.</b>	:	DTA NO. 822245
	:	
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, 2004 through February 28, 2007.	:	

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Petitioner, Register and Grill Manufacturing Co., 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 June 1, 2004 through February 28, 2007.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on February 24, 2009 at 10:30 A.M., with all briefs to be submitted by May 29, 2009, which date began the six-month period for the issuance of this determination. Petitioner appeared by Ronny Buni, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Peter B. Ostwald, Esq., of counsel).

***ISSUE***

Whether, after the parties executed a Test Period Audit Method Election for use in performing an audit of petitioner's sales, the Division of Taxation properly performed a detailed audit of petitioner's sales tax payable accrual account and thereby determined an understatement of tax reported and remitted.

***FINDINGS OF FACT***

1. A sales tax field audit of Register and Grill Manufacturing Co., Inc. (petitioner) was commenced by the Division of Taxation (Division) in April 2007. An appointment letter was mailed on April 9, 2007 along with a written request for records. All records requested for the audit were made available by petitioner.

2. Gross sales per records were reconciled to federal income tax returns and sales tax returns. Gross sales were found to be in substantial agreement with the sales reported on the federal income tax returns and with the sales reported on petitioner's sales tax returns.

3. On August 9, 2007, the parties executed a form AU-377.12, Test Period Audit Method Election, whereby it was agreed that the period September 1, 2006 through November 30, 2006 would be utilized because this period was representative of business activity.

The test period election form contained three boxes for the purpose of setting forth whether the test period audit method would be used to audit: sales, recurring expense purchases or fixed asset acquisitions. On the form utilized in the audit at issue herein, an "X" was placed only in the box indicating "sales."

4. On August 9, 2007 and August 15, 2007, respectively, petitioner and the Division executed a consent extending the period of limitations for assessment of sales and use taxes whereby it was agreed that taxes due for the period June 1, 2004 through August 31, 2004 could be determined at any time on or before December 20, 2007.

5. Petitioner's sales records were reviewed utilizing the test period method referred to in Finding of Fact 3. The result of this review was that petitioner had additional taxable sales of \$15,215.00, with additional sales tax due thereon in the amount of \$1,284.16, plus interest, for the period June 1, 2004 through February 28, 2007.

Additionally, sales tax records were reviewed utilizing a cursory review method. This review disclosed that petitioner had additional taxable sales of \$12,555.00, with sales tax due thereon in the amount of \$1,060.93, plus interest, for the period June 1, 2004 through February 28, 2007.

As a result thereof, the Division, on February 15, 2008, issued a Statement of Proposed Audit Change for Sales and Use Tax to petitioner in the amount of \$2,345.09 (the sum of the \$1,284.16 and \$1,060.93 determined above), plus interest of \$561.54, for the period June 1, 2004 through February 28, 2007. On February 28, 2008, petitioner's representative consented to the amounts determined in the Statement of Proposed Audit Change for Sales and Use Tax.

6. During cross examination, the auditor stated that he examined petitioner's records with respect to exempt sales, freight charges, sales tax charged and sales tax collected. As to exempt sales, after examining petitioner's records during the test period, the auditor found no reason to assess additional sales tax.

For freight charges, the auditor found instances during the test period where petitioner had failed to charge sales tax for freight on its invoices, and taking the result from the test period, the auditor projected it throughout the audit period.

The auditor examined petitioner's records during the test period for sales tax charged to determine whether petitioner charged the proper rate of tax on its invoices. Again, some discrepancies were found and the results from the test period were projected throughout the audit period.

7. At the hearing held in this matter, petitioner's representative stated that he concurred with the field audit findings with respect to the auditor's findings for exempt sales, freight and sales tax charged. This concurrence is evidenced by the fact that he consented to the amounts

determined by the auditor in the February 15, 2008 Statement of Proposed Audit Change for Sales and Use Tax (*see* Finding of Fact 5).

8. With respect to sales tax collected, however, the test period of September 1 through November 30, 2006 was not utilized. The auditor stated that for sales tax accruals, since “it’s just a matter of transcribing individual monthly totals,” a test period analysis is not applied to reconciliations; “it’s applied to reviewing of invoices.” Instead, the auditor transcribed, on a per month basis, the amount of tax collected by petitioner and compared the result with the sales tax paid to the State of New York per its sales tax returns. For the audit period, the auditor found that petitioner had collected \$41,281.00 in sales tax, but had reported \$37,120.00 on its sales tax returns for the audit period. Accordingly, an additional Statement of Proposed Audit Change for Sales and Use Tax was issued to petitioner on February 15, 2008, resulting from this examination of sales tax collected, which indicated that additional sales tax was due in the amount of \$4,149.00, plus interest, for a total amount due of \$5,177.60 for the period June 1, 2004 through February 28, 2007. It must be noted that additional amounts were due only for the quarters ended November 30, 2004 (\$1,001.00), November 30, 2005 (\$1,261.00), February 28, 2006 (\$1,843.00) and February 28, 2007 (\$144.00).

For the sales tax quarter ended November 30, 2006, the test period utilized by the auditor for all other portions of the audit, petitioner reported \$3,857.00 on its sales tax return while, pursuant to its books, it had collected only \$3,757.00. Accordingly, since petitioner had reported more than it had actually collected, had the test period been utilized for the sales tax collected portion of the audit as well, no additional tax would have been due from petitioner for this portion of the audit.

9. Petitioner did not consent to the finding set forth in the Statement of Proposed Audit Change for Sales and Use Tax issued as the result of the auditor's examination of petitioner's sales tax accrual account (*see* Finding of Fact 8). Therefore, on February 29, 2008, the Division issued a Notice of Determination to petitioner assessing tax in the amount of \$4,249.00, plus interest of \$1,053.75, less a credit of \$108.52, for a total amount due of \$5,194.23 for the sales tax quarters ended November 30, 2004, November 30, 2005, February 28, 2006 and February 28, 2007.

### ***SUMMARY OF THE PARTIES' POSITIONS***

10. Petitioner contends that the test period agreement entered into between the parties mandates that the test period (September 1, 2006 through November 30, 2006) must be utilized for the entire audit, including that portion relating to sales tax collected. Had the test period not been applicable to the entire audit, the agreement should have so specified.

11. The Division responds that the test period agreement applies to an audit of sales invoices and does not limit the Division's approach to additional audit examinations such as the detailed reconciliation of petitioner's sales tax payable accrual account. The detailed reconciliation of the sales tax payable accrual account transcribed petitioner's own records to determine whether the amount of sales tax collected was properly reported and remitted to New York State. Petitioner cannot claim that the Division's audit method is unreasonable when petitioner's own records are utilized.

### ***CONCLUSIONS OF LAW***

A. It is well established that the Division may, in appropriate circumstances, resort to a test period audit method in arriving at its determination of tax due. However, in *Matter of Chartair v. State Tax Commn.* (65 AD2d 44, 411 NYS2d 41 [1978]), the Court stated:

Although there is statutory authority for the use of a “test period” to determine the amount of tax due when a filed return is incorrect or insufficient (Tax Law § 1138, subd. [a]), resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit [citations omitted]. However, if records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent become arbitrary and capricious and lack a rational basis [citation omitted]. (*Id.*, 411 NYS2d at 43.)

B. While the absence of adequate and complete records allows the Division to proceed with indirect auditing methods (*id.*), the maintenance of adequate and complete records rightfully entitles a taxpayer to have such records used in the conduct of an audit. The Division cannot simply ignore a taxpayer’s records and use an indirect method of estimating tax due if the taxpayer’s records are readily available and provide an adequate basis on which to determine the amount of tax due (*Matter of Christ Cella, Inc. v. State Tax Commn.*; *Matter of Chartair v. State Tax Commn.*). At the same time, a taxpayer who maintains and makes available complete and adequate records may nonetheless consent to the Division’s use of indirect auditing methodologies, including the test period method. The reasons for making such a consent are various, and may include a taxpayer’s desire to limit the amount of time, cost and personnel required to be devoted to the retrieval and presentation of records necessary for the conduct of a full and detailed audit examination. Whatever the reasons for such a consent, the Division specifically provides for the objective memorialization of such a consent by requiring a taxpayer to execute a Test Period Audit Method Election form.

C. As previously noted, on August 9, 2007, petitioner executed a Test Period Audit Method Election form for the audit of its sales. Subsequently, the auditor, utilizing a test period of September 1, 2006 through November 30, 2006, reviewed petitioner’s sales records and sales tax records and a Statement of Proposed Audit Change for Sales and Use Tax was issued to

petitioner in the amount of \$2,345.09, plus interest. Petitioner's representative consented to the amounts determined therein.

However, with respect to petitioner's sales tax accrual account, the auditor transcribed from petitioner's own records, on a per month basis, the amount of sales tax collected and compared the result with the amount of sales tax paid to the State of New York on its sales tax returns for the audit period. Petitioner does not dispute the amounts determined by the auditor and set forth on the Statement of Proposed Audit Change for Sales and Use Tax, issued February 15, 2008, asserting an amount due of \$4,149.00, plus interest. Petitioner maintains that the auditor should have used the identical test period to determine if more sales tax had been collected than reported on its sales tax returns for the test period, i.e., the sales tax quarter ended November 30, 2006, and argues that if only that quarter had been examined, no additional tax would be due since petitioner had reported more sales tax than actually collected for that quarter.

D. Petitioner's argument is without merit. In the present matter, the Test Method Audit Method Election form executed by the parties indicated that a test period method would be used to audit sales. The Division did, in fact, use the test period of September 1, 2006 through November 30, 2006 to audit petitioner's sales. In reviewing its sales tax accrual account, the auditor stated that it is not the Division's practice to use the test period methodology to audit sales tax accrual accounts. Clearly, there is nothing on the Test Period Audit Method Election form which precludes the Division from performing a detailed audit of petitioner's books and records.

As previously noted, the law is clear that if a taxpayer has complete and adequate books and records (as did this petitioner), such taxpayer is entitled to have its assessment calculated based upon a detailed audit of those records unless the taxpayer consents to the use of an indirect

audit methodology, such as the test period audit performed in the present matter. With the consent of the taxpayer, the Division may agree to perform an audit utilizing an indirect audit method; however, the Division is never precluded from performing a detailed audit of a taxpayer's books and records should such a detailed analysis be deemed more reliable.

E. The petition of Register and Grill Manufacturing Co., Inc., is denied and the Notice of Determination issued on February 29, 2008 is sustained.

DATED: Troy, New York  
November 19, 2009

/s/ Brian L. Friedman  
ADMINISTRATIVE LAW JUDGE