

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
SUNDOWN MEAT, FISH AND LIQUOR CO., INC. :
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, 1981 through May 31, 1984 :

In the Matter of the Petition :
of :
RAYMOND MURPHY, OFFICER OF :
SUNDOWN MEAT, FISH AND LIQUOR CO., INC. :
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, 1981 through May 31, 1984 :

DECISION
DTA Nos. 802322,
802382 and 802383

In the Matter of the Petition :
of :
FRANK BOLOGNA, OFFICER OF :
SUNDOWN MEAT, FISH AND LIQUOR CO., INC. :
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, 1981 through May 31, 1984 :

Petitioners Sundown Meat, Fish and Liquor Co., Inc., Raymond Murphy, officer of Sundown Meat, Fish and Liquor Co., Inc. and Frank Bologna, officer of Sundown Meat, Fish and Liquor Co., Inc., c/o Peter R. Newman, Esq., 700 Veterans Memorial Highway, Hauppauge, New York 11788 filed an exception to the determination of the Administrative Law Judge issued on October 10, 1991 with respect to their 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, 1981 through

May 31, 1984. Petitioners appeared by Peter R. Newman, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel).

Petitioners filed a brief on exception. The Division of Taxation filed a letter in response. Oral argument, requested by petitioners, was denied.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the notices of determination issued to Raymond Murphy and Frank Bologna should be dismissed on the grounds that they were not sent to the individuals' last known addresses.

II. Whether the Division of Taxation properly determined, on the basis of a markup test and an observation test, that Sundown Meat, Fish and Liquor Co., Inc. owed additional sales and use taxes.

III. Whether the Division of Taxation properly imposed a penalty for fraud or whether, in the alternative, the Division of Taxation established that petitioner was liable for a penalty for failure to pay tax when due.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and make an additional finding of fact. The Administrative Law Judge's findings of fact and the additional finding of fact are set forth below.

Petitioner Sundown Meat, Fish and Liquor Co., Inc. ("Sundown") operated a bar named Sunshine's which provided music and dancing. The average age of Sundown's patrons was approximately 19 or 20. Petitioner Donna Autuori owned one-third of Sundown's stock and held

the title of president.¹ Donna Autuori's husband, Michael Autuori, worked as the general manager. Frank Bologna owned one-third of Sundown's stock and held the office of vice-president. Raymond Murphy owned the remaining stock and held the title of secretary.

In May 1984, the Division of Taxation ("Division") assigned an auditor to conduct an audit of Sundown. Thereafter, the Division mailed a letter scheduling an audit appointment at Sundown's premises on July 23, 1984 at 9:50 A.M. The letter requested that Sundown make available all books and records pertaining to its sales tax liability for the period under audit including journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records. A separate request was made that petitioner provide, for the audit period, its general ledger, cash receipts journal, cash disbursements journal, Federal income tax returns for the years 1982 and 1983, sales tax returns and cancelled checks for the quarters ended February 28, 1984 and May 31, 1984, sales invoices for the period June 1, 1983 through August 31, 1983, all fixed asset invoices for fixed assets acquired during the audit period, and resale, exempt and capital improvement certificates supporting nontaxable sales for the period June 1, 1983 through August 31, 1983.

On the scheduled appointment date, the auditor went to Sundown's premises and found that no one was present. The auditor returned during the afternoon of another day and met an individual who provided the name of Sundown's representative. Subsequently, the auditor met with Sundown's representative.² During this meeting, the auditor observed that the representative had the audit appointment letter in his possession. The representative was able to supply Federal income tax returns, the general ledger and records pertaining to cash receipts and cash disbursements. The Division's field audit report indicates that other records made available were

¹The Administrative Law Judge granted the petition of Donna Autuori, officer of Sundown Meat, Fish and Liquor Co., Inc. Therefore, this opinion addresses only the petition of the corporation and Raymond Murphy and Frank Bologna as officers of the corporation.

²Donna Autuori signed the power of attorney form which authorized the representative to appear on Sundown's behalf.

depreciation schedules, purchase invoices and monthly bank statements. Since Sundown's cash registers did not use cash register tapes, Sundown was unable to supply this item. Further, Sundown was unable to supply guest checks because this item was not used.

During the audit, the Division found that gross sales reported on Sundown's corporate Federal income tax return for the fiscal year ended March 31, 1983 were \$184,940.19, whereas the sales on the sales and use tax returns for the same period were \$139,884.00. The Division also compared the sales reported on Sundown's sales and use tax returns with the sales shown on the general ledger. This examination disclosed an underreporting of sales on the sales tax returns of \$158,550.28 as follows:

| <u>Period Ended</u> | <u>Sales Per General Ledger</u> | <u>Sales Per Sales and Use Tax Returns</u> | <u>Difference</u> |
|---------------------|-------------------------------------|--|-------------------|
| August 31, 1981 | \$ 59,634.28 | \$ 32,801.00 | \$ 26,833.28 |
| November 30, 1981 | 35,359.99 | 31,669.00 | 3,690.99 |
| February 28, 1982 | 33,980.43 | 33,594.00 | 386.43 |
| May 31, 1982 | 26,493.33 | 27,881.00 | (1,387.67) |
| August 31, 1982 | 66,540.48 | 46,985.00 | 19,555.48 |
| November 30, 1982 | 36,499.05 | 36,534.00 | (34.95) |
| February 28, 1983 | 34,024.43 | 29,959.00 | 4,065.43 |
| May 31, 1983 | 72,352.58 | 23,460.00 | 48,892.58 |
| August 31, 1983 | 75,837.55 | 54,268.00 | 21,569.55 |
| November 30, 1983 | 37,336.10 | 41,336.00 | (3,999.90) |
| February 28, 1984 | 51,402.94 | 41,635.00 | 9,767.94 |
| May 31, 1984 | <u>70,619.12</u> | <u>41,408.00</u> | <u>29,211.12</u> |
| | \$600,080.28 | \$441,530.00 | \$158,550.28 |

The Division computed the markup on Sundown's purchases from the amounts reported on the corporation Federal income tax returns for the fiscal years ended March 31, 1983 and March 31, 1984. This disclosed markups of 109% and 169%, respectively. On the basis of the auditor's experience and the experience of those in his office, the auditor concluded that these markups were low.

An auditor met with Sundown's representative on approximately eight occasions. On each occasion, the representative was cooperative. In one meeting, Mr. Murphy and Mr. Bologna were also in attendance. During this meeting, the auditor recalled being told that Sundown had a

\$1.00 admission charge at all times. The auditor was also told that Sundown did not employ any bartenders.

In order to determine the amount of sales and use taxes due, the Division decided to conduct an observation test and a markup test on beer and liquor purchases.

The Division's markup test on purchases of liquor began with the auditor's preparation of a worksheet based on Sundown's purchases in March 1984. The worksheet had columns which listed the supplier, the size of the bottle and the cost per bottle. Next the auditor calculated the number of drinks per bottle using a 1¼-ounce shot glass after a 15% allowance for spillage. The total number of drinks was calculated by multiplying the number of bottles purchased by the number of drinks per bottle. The auditor then determined the amount of Sundown's sales by multiplying the total number of drinks by the selling price per drink. Finally, the auditor divided the sales by the cost of the bottles and computed a markup on liquor of 7.0922.³

In order to calculate the markup on beer, the Division utilized Sundown's purchases for the months of March, April and May 1984. Sundown's purchases and costs were determined from its invoices, and its selling prices were determined from information provided by Sundown. The level of sales was calculated by multiplying the selling price per bottle by the number of bottles purchased. The Division then divided the sales by the cost of the beer purchases to calculate a beer markup of 2.5654.

In the course of the audit, the Division determined that Sundown had promotions known as "ladies' night" and "2-for-1 night". On ladies' night, women were charged \$6.00 for admission and thereafter were permitted to drink beer and bar brand liquor without an additional charge. Women were charged \$1.00 for certain other brands of liquor. Men were charged \$3.00 for admission on ladies' night. On 2-for-1 nights, patrons were given two drinks for the price of one.

³In performing the foregoing analysis, the level of purchases was obtained from purchase invoices which were traced to the cash disbursements book. The amounts used for the selling price of drinks were obtained from Sundown.

In order to take promotional events into account, the Division determined that of the 234 days that Sundown was in operation during the year, there were 104 ladies' nights, 104 2-for-1 nights and 26 nights when there was no promotional special. Upon translating the relative number of days into percentages, the Division then took the promotional events into account by marking up only one-half of the beer purchases and only one-half of the wine and liquor purchases. Of the purchases of beer, wine and liquor which were marked up, 55.556% was marked up at the full calculated markup and 44.444% was marked up at one-half of the calculated markup. Utilizing this method, the Division computed taxable beer sales of \$145,946.27 and taxable wine and liquor sales of \$749,527.77. Since some drinks were sold for \$1.00 on ladies' night, the Division added an additional \$20.00 a week for each of the 156 weeks during the audit period on the premise that 10 drinks at \$1.00 a drink were sold during each of the two ladies' nights per week.

In calculating Sundown's taxable sales, the Division included the vendors' purchases of food at cost. This item increased taxable sales by \$38,118.81.

In order to determine the tax due on admission charges, the Division relied upon its findings during two observations of Sundown. During each observation, the Division found that between 200 and 250 people were in attendance. Therefore, the Division based its calculation of admission charges on the premise that 200 customers were in attendance each night and that one-half the patrons were men and one-half the patrons were women. The Division also considered that, at the time of the observations, the admission charge was \$3.00 a person and that, on ladies' night, women were charged \$6.00 for admission and men were charged \$3.00. Using this information, the Division determined that Sundown received \$468,000.00 in admission charges during the audit period as follows:

| | |
|-------------------------------------|-------------|
| Thursdays and Saturdays - | |
| 200 people a day at \$3.00 a person | \$ 1,200.00 |
| Ladies' Night - | |

| | |
|------------------------------------|-----------------------------|
| Wednesday and Friday - | |
| 100 men a day at \$3.00 a person | 600.00 |
| Wednesday and Friday - | |
| 100 women a day at \$6.00 a person | <u>1,200.00</u> |
| | \$ 3,000.00/week |
| | x 156/weeks in audit period |
| | <u>\$468,000.00</u> |

On the basis of the foregoing audit, the Division found that petitioner had total audited taxable sales of \$1,404,712.85, while taxable sales reported were \$441,530.00, resulting in additional taxable sales of \$963,182.85. The additional taxable sales found during the audit were divided by the taxable sales reported on Sundown's sales and use tax returns to calculate a margin of error of 2.18147. The Division then multiplied the taxable sales reported on Sundown's quarterly sales and use tax returns by the margin of error to calculate an increase in taxable sales per audit of \$963,184.44. The taxable sales per audit were then calculated by adding the increase in taxable sales to the taxable sales reported by Sundown on its sales and use tax returns. The Division determined that the tax due on sales was \$101,052.05 by multiplying the tax rate by the total taxable sales from the audit. The Division also concluded that sales and use taxes were due on Sundown's purchase of fixed assets of \$5,954.27 upon which no tax was paid, resulting in additional tax due of \$431.71. Finally, the Division found that sales and use taxes were due on Sundown's purchases of beer and liquor which was subsequently given away. The last item resulted in tax due of \$1,115.06. The Division subtracted the sales and use taxes paid with the returns in the amount of \$23,966.52 from the total tax determined on audit of \$102,598.82 to calculate that the total tax due was \$78,632.30.

The Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated June 20, 1985, to Sundown Meat, Fish and Liquor Co., Inc. The notice assessed sales and use taxes for the period June 1, 1981 through May 31, 1984 in the amount of \$78,632.30, plus penalty of \$39,316.18 and interest of \$25,634.34, for a total amount due of \$143,582.82. The penalty was asserted for fraud pursuant to Tax Law § 1145(a)(2) because of

the large discrepancy between the sales shown on the books and Federal income tax returns of Sundown as opposed to the sales which were shown on the sales tax returns.

The Division also issued notices, dated June 20, 1985, to Donna Autuori, Frank Bologna and Raymond Murphy, as president, vice-president and secretary of Sundown, respectively. Each of the notices assessed the same amount of tax, penalty and interest which was assessed against Sundown. Further, each of the notices explained that, as officers of Sundown, they were personally liable for the taxes determined to be due.

Neither the notices issued to Sundown nor the notices issued to the individual officers indicated that the notices had been estimated in accordance with Tax Law § 1138(a)(1).

The notice intended for Donna Autuori spelled her surname as "Autuoria" and listed her address as "Lenox Road, Huntington Station, New York 11743". The notice issued to Frank Bologna listed his address as "7-5th Avenue, East Northport, New York 11731" and the notice issued to Raymond Murphy listed his address as "East Main Street, Huntington, New York, 11743". The addresses on the notices corresponded with the addresses for the individual petitioners in the Division's audit report.

One observation test occurred between 10:00 P.M. and 2:00 A.M. on Friday, March 1, 1985. On this night, the auditor paid \$3.00 for admission and found a crowded bar serviced by three barmaids. Thereafter, the auditor stood at various locations and counted the customers. As a result, the auditor concluded that a minimum of 200 people patronized Sundown's premises. During this period, the auditor observed that both men and women were drinking beer, but he could not ascertain how much beer was being drunk by men and how much was drunk by women. It was also possible for someone to have left the bar and returned without being noticed by the auditor. Lastly, as this was a ladies' night, it was possible for a woman to get a free drink and hand it to a male companion without being noticed.

At the hearing, one of the auditors who conducted the observation could not recall the decor of Sundown, whether there was more than one floor or whether there was a disc jockey. When asked to draw an outline of the bar, he drew a rectangular-shaped room.

Sundown was located adjacent to another bar frequented by college students known as Dock's End. Each establishment had a distinct decor. Dock's End was dimly lit and decorated with dark wood. Sundown was more colorful and had bright lighting. Unlike Dock's End, Sundown had a canopy above its bar that was 57 feet long. In addition, unlike Dock's End, Sundown had a disc jockey on Friday nights.

Sundown and Dock's End had different physical configurations. Dock's End had a rectangular-shaped room. The premises of Sundown was on two levels. Patrons entered on the first level which contained a bar. This portion of Sundown was approximately 14 feet by 54 feet. The west half of Sundown was raised approximately three steps. This half was approximately 14 feet wide by 110 feet long. One could not see from one level of Sundown to the other level because the two levels were separated by a divider, window boxes and plants.

The amount which Sundown charged for admission varied during the night. At the start of an evening, when Sundown did not have many patrons, Sundown either charged nothing or \$1.00. As the establishment became busier, the admission charge increased to \$3.00.

During the period in issue, Donna Autuori was the executive vice-president of a public relations firm on Long Island. In this position she was required to work more than 40 hours a week. On many evenings, she was required to work at home or at other locations.

The funds for Donna Autuori's investment in Sundown were borrowed from her father. Since the Autuoris had not been married for a long period of time, it was decided that the stock ownership would be placed in Donna's name in order to protect her interests. Donna Autuori's father thought that she should hold the title of president for the same reason. Although Donna Autuori held the title of president, she was only at Sundown in the evening on approximately two occasions. Donna Autuori did not work at Sundown in any capacity, did not have any role in the

decision-making process and did not have any input into decisions regarding the expenditure of funds. Although Donna Autuori was an authorized signatory on the corporation's checking account, she never signed any of Sundown's checks.

Sundown filed a U.S. Corporation Income Tax Return for the fiscal year ended March 31, 1983. The schedule E portion of this return entitled, Compensation of Officers, stated that each of the officers worked part time for the business. The names of the officers and their respective compensations were reported as follows:

| <u>Officer</u> | <u>Compensation</u> |
|----------------|--------------------------|
| Donna Autuori | \$ 1,300.00 ⁴ |
| Raymond Murphy | 11,050.00 |
| Frank Bologna | 16,250.00 |

Sundown filed a U.S. Corporation Income Tax Return for the fiscal year ended March 31, 1984. The schedule E portion of the return, entitled Compensation of Officers, stated that each of the officers worked part time for the business. The names of the officers and their respective compensations were reported as follows:

| <u>Officer</u> | <u>Compensation</u> |
|----------------|---------------------|
| Donna Autuori | \$ -0- |
| Raymond Murphy | 13,700.00 |
| Frank Bologna | 13,700.00 |

In or about June 1984, the shareholders of Sundown filed an Election by Shareholders of a Small Business Corporation for New York State Personal Income Tax and Corporation Franchise Tax Purposes for the period April 1, 1984 through March 31, 1985. The form, which stated that Donna Autuori, Frank Bologna and Raymond Murphy each owned ten shares of stock, was signed by Raymond Murphy, as secretary. Donna Autuori's address was listed on this form as 434 Lenox Lane, Huntington Station, New York 11746. Frank Bologna's address was reported as 7 Fifth Avenue, East Northport, New York 11731, and Raymond Murphy's address was listed as 82 Main Street, Huntington, New York 11743.

⁴At the hearing, Donna Autuori denied any recollection of having received these funds.

In addition to the facts found by the Administrative Law Judge, we find the following:

Donna Autuori, Frank Bologna and Raymond Murphy each filed a timely petition. In each case, the petition listed the appropriate Notice of Determination number, periods covered and amount of tax, penalty and interest assessed. None of these petitioners have asserted that they did not receive the notice issued to them.

OPINION

In the determination below, the Administrative Law Judge held that petitioners failed to sustain their burden of proof to establish that the notices of determination were not sent to their last known addresses. The Administrative Law Judge pointed out that the reliance of petitioners' representative on the power of attorney forms filed with the petitions was misplaced because they were all dated after the notices were issued. The Administrative Law Judge stated that the only evidence in the record as to petitioners' addresses which predated the hearing notice was consistent with the addresses on the notices of determination.

The Administrative Law Judge also held that the Division requested an opportunity to examine Sundown's books and records and that Sundown was unable to present any original sales documents. Therefore, the use of external indices by the Division was proper since it was impossible to verify taxable sales independently. The Administrative Law Judge rejected: 1) petitioners' argument that one of the observers must have examined Dock's End rather than Sundown; 2) for lack of documentary support, petitioners' argument that 200 people could not have fit into the lower level of Sundown; 3) petitioners' argument that the first observer could not have seen the number of people who entered the door at Sundown; and 4) petitioners' questioning of the auditor's credibility, holding that the auditor's testimony was candid and forthright. The Administrative Law Judge held that it was petitioners' failure to present auditable records which necessitated the use of an estimate. The Administrative Law Judge further held that the Division has failed in its burden of proving fraud by clear and convincing evidence, concluding that the record did not show clear, definite and unmistakable evidence of every element of fraud. However, the Administrative Law Judge did find that, in view of petitioners' apparent

carelessness in complying with their sales and use tax obligations, the Division had shown that the failure to pay was due to willful neglect. Thus, the alternative penalty asserted pursuant to Tax Law § 1145(a)(1) was sustained.

On exception, petitioners argue that the findings of fact and conclusions of law made by the Administrative Law Judge must be reversed, and allege, as they did below, that the auditor conducted his "observation" at the wrong location, and that, therefore, the observation is invalid. Petitioners request that their petitions be sustained because the audit was based upon an inherently faulty observation and, further, that the notices of determination be deemed ineffectual because they were mailed to the wrong addresses.

The Division argues: that the notices of determination were properly addressed; that the audit method was proper under section 1138 of the Tax Law and the notices of determination asserted a correctly calculated tax; that petitioners' returns were insufficient and petitioners' records were inadequate to permit the determination of tax by reference of such records; that the observation test was not flawed; that petitioners failed to sustain their burden; and that penalty for failure to pay was properly asserted and proven. The Division requests that the determination of the Administrative Law Judge be affirmed and petitioners' exception be denied.

We find no basis in the record before us for modifying the determination of the Administrative Law Judge in any respect. Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated in said determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Sundown Meat, Fish and Liquor Co., Inc., Raymond Murphy, officer of Sundown Meat, Fish and Liquor Co., Inc., and Frank Bologna, officer of Sundown Meat, Fish and Liquor Co., Inc., is denied;
2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Sundown Meat, Fish and Liquor Co., Inc., Raymond Murphy, officer of Sundown Meat, Fish and Liquor Co., Inc., and Frank Bologna, officer of Sundown Meat, Fish and Liquor Co., Inc., are granted to the extent indicated in the Administrative Law Judge's conclusions of law "K," "L" and "T," but are otherwise denied; and

4. The Division of Taxation is directed to modify the notices of determination and demand for payment of sales and use taxes due dated June 20, 1985 in accordance with paragraph "3" above, but such notices are otherwise sustained.

DATED: Troy, New York
September 24, 1992

/s/John P. Dugan

John P. Dugan
President

/s/Francis R. Koenig

Francis R. Koenig
Commissioner

/s/Maria T. Jones

Maria T. Jones
Commissioner