

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petition :  
of :  
**GREAT SOUTH BAY DELICATESSEN, INC.** : DECISION  
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 September 1, 1982 :  
through July 15, 1985. :

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Petitioner, Great South Bay Delicatessen, Inc., c/o Robert E. Dunn, Esq., 12 Jean Court, Farmingdale, New York 11735, filed an exception to the determination of the Administrative Law Judge issued on October 12, 1989 with respect to its 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 September 1, 1982 through July 15, 1985 (File No. 802820). Petitioner appeared by Robert E. Dunn, Esq. The Division of Taxation appeared by William F. Collins, Esq., (Michael J. Glannon, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division filed a brief in opposition. Oral argument was not requested.

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

***ISSUES***

I. Whether the Division of Taxation properly determined upon audit that petitioner Great Bay Delicatessen, Inc. owed additional sales taxes.

II. Whether petitioner Great South Bay Delicatessen, Inc., the purchaser in a bulk sales transaction, is liable for sales taxes due from the seller in accordance with Tax Law § 1141(c).

III. Whether the Division of Taxation timely notified petitioner Great South Bay Delicatessen, Inc. of its obligations as required by Tax Law § 1141(c).

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge and such facts are stated below.

On October 2, 1985, the Division of Taxation issued two notices of determination and demands for payment of sales and use taxes due to petitioner Great Bay Delicatessen, Inc. ("Great Bay"), spanning, together, the period September 1, 1982 through July 15, 1985 and assessing a sales tax liability in the aggregate amount of \$29,296.93, plus penalty (Tax Law § 1145 [former (a)(1)]) and interest. On the same date, the Division of Taxation issued two additional notices of determination and demands for payment of sales and use taxes due spanning the same period and assessing the same amounts as above, against petitioner Howard B. Lockmuller (Deceased) as a person required to collect and remit taxes on behalf of Great Bay. In addition, the Division of Taxation issued on the same date two notices of determination and demands for payment of sales and use taxes due for the same period and assessing the same amounts as above, against petitioner Great South Bay Delicatessen, Inc. ("Great South Bay") as a purchaser in a bulk sale from Great Bay. These six notices were all based upon the results of a field audit of the business operations of Great Bay as described hereinafter.

On May 9, 1985, the Division of Taxation received a Notification of Sale, Transfer or Assignment in Bulk dated May 3, 1985. The notification indicated that a bulk sale of the business operated at 539 East Main Street, Bayshore, New York was to occur between Great Bay, as seller, and Great South Bay, as purchaser, on "approximately July 15, 1985". The notification further indicated that the scheduled date of sale was to be "within 72 hours of issuance of off premises beer license." Subsequently, on July 17, 1985, the Division of Taxation received a letter from petitioner's representative indicating that the sale of the business occurred on July 12, 1985.

On May 10, 1985, the Division of Taxation notified Great South Bay of a possible claim for New York State and local sales and use taxes due from the seller.

On May 24, 1985, the Division of Taxation notified Great Bay, the seller, that it would be contacted to make arrangements for an examination of its books and records. Thereafter, on July 31, 1985, an audit appointment letter was mailed to Great Bay requesting that it contact the Division of Taxation to arrange an appointment date. This appointment letter specified the audit period to be September 1, 1982 through May 31, 1985, and indicated that all records pertaining to Great Bay's sales tax liability should be available for review including, but not limited to, journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and any other sales tax records.

On August 22, 1985, the auditor made a visit to the business premises. The premises consisted of a delicatessen selling prepared food, such as salads and sandwiches, and unprepared foods or groceries. At the time of the audit, the business premises were open 7 days a week, 6:00 A.M. to 9:00 P.M. Great South Bay had purchased the business from Great Bay on July 12, 1985. Prior to the purchase, the premises were also used for the operation of a delicatessen.

The Division of Taxation was advised by Mr. Lockmuller, in a letter dated June 10, 1985 and written on an invoice with the name, address and telephone number of Great Bay, that the books and records of the business were maintained at the offices of Leventhal & Leventhal, Great Bay's accountants. On August 23, 1985, the auditor went to the accountants' office. The auditor was provided with sales tax returns, Federal and State income tax returns, a check disbursements journal and a cash receipts book containing bank deposits. The auditor was not provided with cash register tapes or other source documents which delineated the business's sales activities or the amount of tax collected on each sale. Furthermore, the auditor was not provided with any records which showed how the reported sales tax was determined for each audit period.

The auditor was informed by Great Bay's accountant that he employed an estimated taxable ratio in reporting the sales tax due on Great Bay's New York State and local sales and use tax returns for the period in issue. The taxable ratio, according to the accountant, was derived from Great Bay's "day book", which was used to record cash purchases and sales. During the audit period, the estimated taxable ratios employed were as follows:

<u>Period</u>	<u>Taxable Ratio</u> <u>(Taxable Sales/Gross Sales)</u>
11/30/82	.266
2/28/83	.266
5/31/83	.266
8/31/83	.266
11/30/83	.261
2/29/84	.246
5/31/84	.266
8/31/84	.266
11/30/85	.266
2/28/85	.260
5/31/85	.250
8/31/85	.266

The auditor made both an oral and written request for the day book on August 23, 1985, but it was not provided by either the accountant or Great Bay. Included in the written demand was a request for the purchase invoices for the months of February, May, August and November of either 1983 or 1984. These were not provided to the auditor until October 4, 1985.

Given the presentation of the limited records described above, the use of an estimated taxable ratio to report sales tax due and the lack of source documentation which would detail the sales activities and the amount of sales tax collected, the auditor concluded that Great Bay had inadequate books and records for purposes of conducting a detailed audit and therefore determined to resort to indirect audit methodologies. More specifically, the auditor conducted an observation of the premises on September 24, 1985 between the hours of 8:00 A.M. and 3:00 P.M.

During the course of the observation, the auditor totalled all taxable sales made. The auditor recorded \$486.24 in taxable sales of prepared foods during the period from 8:00 A.M. to 3:00 P.M. The auditor assumed that all sales made prior to his arrival were taxable, while all

sales made after his departure were nontaxable. The auditor added to the taxable sales he had observed \$75.69, which was the amount of sales that had occurred prior to his arrival. Total taxable sales of \$561.93 were compared to gross sales for the day, less sales tax collected, to arrive at a percentage of prepared food sales to gross sales of 50.96%. This percentage was reduced by 1/7 by the auditor to take into account reduced prepared food sales on Saturday and Sunday. Accordingly, the auditor determined that 43.68% of gross sales were taxable prepared food sales. Due to the failure of Great Bay to produce the purchase invoices requested (see Finding of Fact "7") prior to the time limitation of section 1141(c) of the Tax Law, the auditor was unable to determine a taxable ratio for unprepared food sales. Instead, based upon his review of the business premises, the books and records provided and the observation test, the auditor estimated a total taxable ratio of 65% for the audit period.

In reviewing the records of petitioner for the audit period, the auditor discovered that gross sales reported on the sales tax returns were less than gross sales reported on the Federal income tax returns. The auditor computed a margin of error of 1.1037095 and applied it to gross sales as reported on the sales tax returns in the audit period to arrive at audited gross sales. This amount was multiplied by the taxable ratio of 65% to arrive at audited taxable sales. The auditor compared this total to the total taxable sales reported per Great Bay's sales tax returns and arrived at a \$401,376.84 increase over taxable sales reported, with additional tax due computed thereon in the amount of \$29,296.93. In turn, the notices of determination described above were issued to petitioners. The auditor recommended that penalty be assessed based primarily on the lack of records and the comparison of reported taxable sales by Great Bay (\$19,272.00 per quarter) versus taxable sales determined upon audit (\$52,720.00 per quarter).

Following the issuance of the notices of determination, the auditor was provided with the purchase invoices previously requested of Great Bay. The auditor analyzed the purchase invoices and determined a taxable ratio for unprepared foods of 27.64% and applied it to total purchases for the period September 1, 1982 through February 28, 1985 to arrive at total taxable

purchases for that period. The auditor then applied a markup percentage of 40% to determine audited taxable sales of unprepared foods for such period.

To determine the markup percentage, the auditor reviewed an analysis performed by the Division of Taxation (Suffolk County District Office) of markups used by numerous delicatessens in Suffolk County. The analysis consisted of 33 delicatessens with an average grocery markup of 51.03%. The grocery markups ranged from a low of 34.55% to a high of 77.71%. Based upon a review of Great Bay's books and records, its business operation and his own experience, the auditor determined that a 40% markup was appropriate.

The audited taxable sales for both prepared and unprepared foods were totalled to arrive at total taxable sales. The auditor compared this total to the taxable sales reported by Great Bay for the period September 1, 1982 through February 28, 1985, and arrived at a \$373,074.06 increase over taxable sales reported. The amount of purchases for the periods ended May 31, 1985 and July 15, 1985 were provided to the auditor by letter from Mr. Lockmuller. The auditor chose not to use these purchase amounts because they were substantially less than previous quarters while sales during the quarter ended May 31, 1985 had increased over the prior quarters. Instead, the auditor multiplied the total sales reported for the two periods by a ratio using the earlier quarters of additional taxable sales to total reported taxable sales to arrive at additional taxable sales for the last two periods of \$48,306.69. This figure was added to the additional taxable sales for the earlier quarters to arrive at additional taxable sales for the audit period of \$421,380.75. The taxable ratio using this audit methodology was 67%. Although the additional taxable sales and taxable ratio were larger than those used in issuing the original notices of determination, the auditor did not re-issue the notices of determination to petitioners because allowances for personal use, pilferage and breakage had not been originally considered. The auditor reasoned that if these items were allowed in the audit methodology resulting in the higher taxable sales, the additional tax due would be approximately the same as the amounts on the notices of determination as issued.

At the initial hearing held on May 12, 1988, Great Bay and the Estate of Howard B. Lockmuller appeared by William J. Bernstein, Esq., pursuant to a power of attorney executed by Mrs. Florence Lockmuller as the president of Great Bay and the personal representative of the Estate of Howard B. Lockmuller.<sup>1</sup> At the hearing, Mr. Bernstein and Mrs. Lockmuller indicated that there had been no probate proceedings in the matter of Mr. Lockmuller and that there would be none in the future. Following the initial hearing date and prior to the second hearing date, two letters were received by the Division of Tax Appeals from Mrs. Lockmuller and Mr. Bernstein. Mrs. Lockmuller indicated that neither Mr. Bernstein nor herself would be appearing at the continued hearing scheduled for February 28, 1989, while Mr. Bernstein indicated that he had been relieved in the Great Bay matter and would not be at the hearing. Neither appeared at the continued hearing.

#### ***OPINION***

The Administrative Law Judge determined 1) that the Division properly resorted to an indirect audit methodology, 2) that petitioner failed to prove that the audit method utilized was arbitrary, 3) that petitioner timely complied with the provisions of the Tax Law and the Division's regulations which require the purchaser in a bulk sales transaction to notify the Division of the sale, 4) that relying on 20 NYCRR 537.2(c)(6), the Division timely issued the notice of determination to petitioner, and 5) that a penalty should be imposed.

The Administrative Law Judge further determined that the Division's regulation (20 NYCRR 537.2[c][6]) is consistent with the purpose of Tax Law § 1141(c) in that it provides the Division with the opportunity to both determine the seller's tax liability to the date of sale and preserve the Division's ability to collect such liability from the proceeds of the sale.

Although a consolidated hearing was held on the petitions of Great Bay, Howard B. Lockmuller and petitioner, only petitioner has filed an exception to the determination of the Administrative Law Judge.

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<sup>1</sup>Mr. Bernstein indicated at the hearing that Mr. Lockmuller's responsibility was not at issue, but only the amount of tax due would be contested.

On exception, petitioner asserts that it is not liable for the taxes determined to be due from Great Bay because the Division did not comply with the requirements of § 1141(c) of the Tax Law. That section provides that "Within ninety days of receipt of the notice of the sale . . . from the purchaser . . . the (Division) shall give notice to the purchaser . . . of the total amount of any tax or taxes which the state claims to be due from the seller . . ." (emphasis added). Petitioner asserts in this regard that as the Notification of Sale, Transfer or Assignment in Bulk was received on May 9, 1985, and the notices of determination were issued on October 2, 1985, the Division of Taxation failed to notify it of any taxes claimed to be due from the seller within 90 days from receipt of the notice of sale.

In the alternative, petitioner challenges the validity of the Division's regulation (20 NYCRR 537.2[c][6]) as being without statutory basis and inconsistent with Tax Law § 1141(c). The regulation provides that a notice of sale received more than 10 days prior to the date of transfer or sale of the business assets "shall be deemed to have been received not more than 10 days prior to the date of taking possession of, or payment for, the business assets whichever come first, regardless of the date when the notice is actually received" (emphasis added). The statute, asserts petitioner, provides only that the notice of claimed taxes due from the seller must be mailed to the purchaser by the Division within 90 days of receipt of the notice of sale. It provides no explicit basis for a "deemed" date of receipt as provided in the regulation. In any event, petitioner asserts that even under the regulation, the notices of determination would be untimely as they were issued more than 90 days after July 2, 1985, 10 days prior to the transfer date of July 12, 1985.

Petitioner also challenges the Administrative Law Judge's conclusion sustaining the amount of the assessment.

The Division asserts that 20 NYCRR 537.2(c)(6) is a valid regulation, consistent with Tax Law section 1141(c), and that the Notices of Determination and Demand were properly and timely issued to petitioner. The Division concedes that penalty and interest prior to October 7, 1985 should be cancelled.

We reverse the determination of the Administrative Law Judge.

Tax Law section 1141(c) provides, in summary, that whenever a person required to collect tax shall make a sale, transfer or assignment of his business assets other than in the ordinary course of business, a notification of sale, transfer, or assignment in bulk must be filed with the Division of Taxation by the purchaser at least ten days prior to such sale, transfer or assignment. Thereafter, the Division of Taxation has a period of 90 days from said notification within which to determine the existence of any outstanding sales and use tax liabilities and to assess the same against the purchaser.

Tax Law section 1141(c) further provides that if a purchaser fails to comply with the aforementioned provisions, it may be held liable for any sales or use taxes determined to be due from the seller limited in amount, however, to the greater of either the purchase price or fair market value of the business assets sold, transferred or assigned.

The purpose of section 1141(c) is twofold: (1) to provide the Division of Taxation with adequate time, prior to the consummation of the sale, to determine whether there are any taxes due the State from the seller of the business and (2) to preserve the Division's ability to collect the seller's liability from the consideration being paid for the assets of the business. The purpose is accomplished by requiring the purchaser to notify the Division of the proposed sale and by requiring the Division to notify the purchaser and the seller of the amount of any outstanding liabilities. This notice secures the Division's first priority right and lien against the consideration for the business.

The crux of the matter here is the proper date from which to measure the 90 days within which the Division must issue the Notice of Determination and Demand to the purchaser in a bulk sale after the purchaser gives notice of the sale. Section 1141(c) says only that the time runs from the date of "receipt of the notice of sale" from petitioner. The regulation provides that where the purchaser gives notice more than ten days prior to the sale, the time runs from a "deemed" date which is the date of "taking possession of, or payment for, the business assets,

whichever comes first, regardless of the date when the notice is actually received" (20 NYCRR 537.2[c][6]).

Here, the Notification of Sale in Bulk was dated May 3, 1985 and was received by the Division on May 9, 1985. The notification indicated that the sale was to occur on "approximately July 15, 1985". The Notification further indicated that the scheduled date of sale was to be "within 72 hours of issuance of off premises beer license".

The sale of the business actually occurred on July 12, 1985, a fact which petitioner brought to the Division's attention by letter dated July 17, 1985.

The notices of determination and demands for payment of sales and use taxes due were issued to petitioner on October 2, 1985.

Applying only the statutory language, the notice would have to be issued within ninety days from May 9, 1985, the date of receipt by the Division of the notice of bulk sale from petitioner. Under these circumstances the notices mailed October 2, 1985 are untimely.

Applying the regulation, the date of transfer was July 12, 1985; therefore, the deemed date is July 2, 1985. Under these circumstances, the notices mailed October 2, 1985 are untimely. The Administrative Law Judge, in applying the regulation, determined that the 90 days should be measured from the "deemed" date of July 5, 1985, i.e., ten days prior to the "approximate" date of July 15, 1985, indicated in petitioner's notice of bulk sale. We disagree. The Administrative Law Judge's conclusion requires reading into the regulation the rule that the "deemed date" is measured from the date indicated by the purchaser in the notice of sale and not from the date of "taking possession of, or payment for, the business assets. . . ." This rule is inconsistent with the explicit wording of the regulation. Nor do we find any basis for it implied by the regulation. Adding any such gloss to the regulation is especially inappropriate because the rule that is stated in the regulation is itself such an artificial construction, i.e., deeming the date of receipt to be other than what it was. Certainly, if the Division has the authority to deem the date of receipt to be some other date, it must do so very explicitly and precisely. Accordingly, we find the Administrative Law Judge's determination contrary to the explicit

language of the regulation and on this basis we reverse the determination of the Administrative Law Judge and conclude the Division's notices were not timely issued to petitioner.

In view of this conclusion, it is not necessary to deal with petitioner's assertion that the Division's regulation is without statutory basis.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Great South Bay Delicatessen, Inc. is granted;
2. The determination of the Administrative Law Judge that Great South Bay Delicatessen, Inc. was liable as a purchaser in bulk for the taxes due from Great Bay Delicatessen, Inc. is reversed but such determination is otherwise affirmed;
3. The petition of Great South Bay Delicatessen, Inc. is granted; and
4. The notices of determination dated October 2, 1985 issued to Great South Bay Delicatessen, Inc. are cancelled.

DATED: Troy, New York  
July 5, 1990

/s/John P. Dugan  
John P. Dugan  
President

/s/Francis R. Koenig  
Francis R. Koenig  
Commissioner

/s/Maria T. Jones  
Maria T. Jones  
Commissioner