

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
GIOVAN DIPIAZZA,	:	DECISION
OFFICER OF G & G PIZZA RESTAURANT	:	DTA No. 803059
D/B/A ROMA PIZZA RESTAURANT	:	
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, 1981 through May 31, 1985.	:	

Petitioner Giovan DiPiazza, Officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant, c/o Peter J. Graham, 1500 Main Street, Port Jefferson, New York 11777 filed an exception to the determination of the Administrative Law Judge issued on January 31, 1991 with respect to his 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, 1981 through May 31, 1985. Petitioner appeared by John P. McElroy, Esq. and Peter J. Graham, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

Both parties filed briefs on exception. Petitioner's request for oral argument was denied.

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

ISSUES

I. Whether the sales tax field audit conducted by the Division of Taxation utilized an audit method reasonably calculated to reflect the taxes due.

II. Whether petitioner proved that the result of the audit method used was unreasonably inaccurate or that the amount of tax assessed was erroneous.

III. Whether petitioner has shown that his failure to comply with the Tax Law, if so determined, was due to reasonable cause and was not due to willful neglect.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "6" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

On December 20, 1985, the Division of Taxation (hereinafter the "Division") issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to G & G Pizza Corporation d/b/a Roma Pizza Restaurant ("G & G Pizza") for the period December 1, 1981 through May 31, 1985 and assessing a sales tax liability of \$54,101.00, plus penalty (Tax Law § 1145 [former (a)(1)]) and interest. On the same date, the Division issued an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due spanning the same period and assessing the same amounts as above, to petitioner, Giovan DiPiazza, as officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant. The notice indicated that petitioner was personally liable as an officer of G & G Pizza for taxes determined to be due from the corporation. The notices were based upon the results of a field audit of the business operations of G & G Pizza as described hereinafter.

On April 25, 1985, the Division sent a letter to Joseph Schwartz, petitioner's accountant at the time, advising him that petitioner's sales tax returns for the period December 1, 1981 through November 30, 1984 were scheduled for field audit. The letter advised that the audit would be conducted at Mr. Schwartz's office and requested that all books and records pertaining to the sales tax liability for the period under audit be made available. The letter further stated that the books and records provided should include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records.

On May 22, 1985, the auditor met with petitioner's accountant to review the books and records of the business operation. The accountant informed the auditor that petitioner did not use guest checks and cash register tapes, and regularly discarded his purchase invoices. In addition, petitioner did not maintain invoices for his fixed asset purchases. To prepare the sales

and use tax returns for the period in issue, the accountant used the deposits as shown on the bank statements. Cash payouts made out of the business's sales proceeds were not included in the gross or taxable receipts stated on the tax returns because the accountant was not aware of them. During the course of the meeting, the auditor requested of the accountant that the business begin to keep its purchase invoices.

On May 28, 1985, auditors made a visit to the business premises. The business was owned by petitioner, a 50% shareholder, and the corporation's vice-president, and his brother, Anthony DiPiazza, also a 50% shareholder and the president of the corporation. The business was located in a shopping center and sold pizza, heroes, pasta, seafood and beverages. Petitioner obtained a license to sell beer on November 10, 1983 and a full liquor license on October 4, 1985. The premises consisted of 8 booths with a seating capacity of approximately 30. During the audit period, the business premises were open seven days a week, from 11:00 A.M. to 11:00 P.M.

On December 23, 1984, petitioner executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period December 1, 1981 through February 28, 1982 to June 20, 1985. On May 22, 1985, petitioner executed a second consent which extended the period of limitations for assessment of sales and use taxes for the same period to December 20, 1985.

We modify finding of fact "6" of the Administrative Law Judge's determination to read as follows:

On July 23, 1985, the Division sent a second appointment letter to petitioner's accountant on which was added an additional request. The letter requested that petitioner make available copies of all purchase invoices for flour purchased during the audit period, December 1, 1981 through November 30, 1984. On September 14, 1985, the accountant presented only a few purchase invoices to the auditor and explained that petitioner continued to discard the invoices despite being informed that such documents should be saved.

In response to the Division's request for flour purchases during the period December 1, 1981 through November 30, 1984, petitioner's supplier provided an approximate dollar value of merchandise sold to petitioner for the period 1981 through 1983 and a portion of 1984. Although requested to provide a breakdown of flour purchased by bags

and pounds, the supplier submitted amounts which included other supplies purchased. The auditor concluded that the information supplied was insufficient to enable her to determine the amount of flour purchased during the audit period.¹

Given the presentation of the limited records described above and the lack of source documentation which would detail the sales activities and the amount of sales tax collected, the auditor concluded that G & G Pizza 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 selected an audit method utilizing a rent factor obtained from the Dun and Bradstreet Credit Services Report for the period July 1976 through June 1977.

The Dun and Bradstreet Credit Services Report, which was used by the auditor in estimating the sales at issue, was introduced into evidence. The study, entitled "Cost of Doing Business", was compiled by Dun & Bradstreet, Inc. based upon Internal Revenue Service data consisting of a sample, selected before audit, of Federal income tax returns. The purpose of the study is described as follows:

"The following operating ratios for 190 lines of business have been derived to provide a guide as to the average amount spent by corporations for these items. They represent a percentage of business receipts as reported by a representative sample of the total of all Federal Income Tax returns filed for 1976-77."

For each industry, the study provides the total number of returns filed, the cost of goods sold percentage, the gross margin percentage and the percentages for selected operating expenses, including rent paid on business property. The ratio used in the audit was calculated based upon an analysis of information contained in 84,964 tax returns filed with the Internal Revenue Service for 1976-1977. The business category selected by the auditor was "eating and drinking places." The information contained in the study was taken from the Source Book of Statistics of Income, U.S. Treasury Department, Internal Revenue Service, Statistics Division. The study used was copyrighted in 1982.

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We modified this fact to indicate that the request for flour purchases was for the period ending November 30, 1984, not May 31, 1985 as stated by the Administrative Law Judge.

In computing the additional taxable sales for the period October 1, 1982 through September 30, 1984, the auditor utilized the rent paid by the business for the fiscal years ended September 30, 1983 and September 30, 1984. The amounts, as shown on the business's Federal income tax returns, were as follows:

<u>Fiscal Year Ended</u>	<u>Amount</u>
September 30, 1983	\$ 7,589.00
September 30, 1984	17,216.00

These two tax returns were used because they were the only ones provided to the auditor. The rent paid was totalled and then divided by the Dun and Bradstreet rent factor of 4.93% to arrive at audited sales for the two-year period of \$503,144.00. The auditor subtracted from audited taxable sales the sales reported of \$134,600.00 to compute additional sales of \$368,544.00. Additional sales were then divided by the sales reported to arrive at a 273.81% increase in sales. This percentage was applied to gross sales as reported on the sales and use tax returns of the business for the period December 1, 1981 through May 31, 1985 to compute additional sales of \$694,688.00 and additional tax due of \$50,365.00 for the audit period. In addition, the auditor reviewed the only five invoices maintained by the business relating to recurring expenses, computed a margin of error and determined additional tax due of \$111.00 on these expenses.

Through discussions with Anthony DiPiazza, the auditor learned that during 1984 the business had made improvements to additional space which was to be used to expand the restaurant. In addition, the auditor was informed that the improvements had been made by Anthony DiPiazza and his brother. As the business failed to present any invoices showing the purchase of the fixed assets used in the construction, the auditor estimated the cost of the expansion to be \$50,000.00 and assessed tax due of \$3,625.00. The total amount of tax due as computed by the auditor was \$54,101.00. The auditor recommended that penalty be assessed based upon the failure of the business operation to maintain proper records.

On February 25, 1980, petitioner's brother, Anthony DiPiazza, purchased 50% of the business operation. During 1981, petitioner purchased the other 50% interest from his brother's partner. At this point in time, the premises leased for the business operation consisted of 1,120 square feet. Pursuant to a lease executed by the former owners of the business, the rental expense during the initial portion of the audit period was as follows:

<u>Period</u>	<u>Monthly Rent</u>
12/1/81 - 1/31/84	\$478.00

On January 26, 1984, the corporation entered into a new lease agreement with the owners of the building where the business was located. The leased premises consisted of 2,320 square feet and required rental payments as follows:

<u>Period</u>	<u>Monthly Rent</u>
2/1/84 - 3/31/84	\$ 827.00
4/1/84 - 5/31/85	\$1,827.00

The additional space covered by the new lease was not initially suitable for use in the restaurant business. Following the improvements made by petitioner and his brother, a Certificate of Occupancy, dated December 6, 1984, was obtained from the Town of Brookhaven Building Department. Although rent was being paid on the additional space, it was not until the Certificate of Occupancy was obtained that such space was employed in the business operation. During the period April 1, 1984 through November 30, 1984, the monthly rental expense can be divided between the original space and the additional space as follows:

$$\begin{aligned} 1,120 \text{ sq. ft.} / 2,320 \text{ sq. ft.} \times \$1,827.00 &= \$882.00 \\ 1,200 \text{ sq. ft.} / 2,320 \text{ sq. ft.} \times \$1,827.00 &= \$945.00 \end{aligned}$$

Thus, the rental expense for the original leased space was \$882.00 per month for the period April 1, 1984 through November 30, 1984. For the same period, the monthly rental expense for the additional space was \$945.00.

During the hearing process, the Division cancelled the \$3,625.00 tax relating to the capital improvements and the \$111.00 tax relating to expense purchases.

At the hearing, Anthony DiPiazza testified that Joseph Schwartz had been the accountant for the business prior to the time when he and his brother took over the restaurant. Since Mr. Schwartz was familiar with the business operation, the brothers continued to employ him following their purchase of the business. According to Mr. DiPiazza, the accountant would come once a month to the restaurant to collect the checks and bank statements which he used to compute the sales and use tax returns. The accountant did not request any other information nor did the business provide any additional information. During the period that Mr. Schwartz was the accountant, petitioner and his brother never had any questions for him because they assumed he knew what records were required to complete the returns. After a period of time, the accountant would send his students to pick up the business's records. Anthony DiPiazza further testified that he was unaware of how the sales and use tax returns were prepared and discarded his records because he was not aware that they had to be saved. He further testified that, during the audit period, cash payouts were made out of the cash register for various supplies needed for the business operation. This information was not given to the accountant because, according to Mr. DiPiazza's testimony, the accountant did not request it.

With regard to the rent expense, Mr. DiPiazza testified that a factor of 10 to 13% would have been more appropriate than the 4.93% used by the auditor. Mr. DiPiazza based his percentage on his own business experience as well as conversations with other pizza restaurant owners.

Opinion

The Administrative Law Judge determined that: the Division properly requested from petitioner his books and records for the audit period; the Division examined the books and records provided to it and properly determined that they were inadequate for purposes of conducting a full audit of petitioner's sales tax liability; the Division properly resorted to the use of external indices to estimate petitioner's tax liability; and the use by the Division of a rent factor of 4.93% from the 1982 copyrighted publication of Dun and Bradstreet known as "Cost

of Doing Business" was appropriate and was reasonably calculated to estimate petitioner's tax liability.

The Administrative Law Judge determined that petitioner established, through the introduction of rental agreements for the years at issue, that the rental expense used by the Division (i.e., the amounts listed on petitioner's 1983 and 1984 Federal income tax returns) was excessive for the earlier years of the audit and that, for a portion of 1984, petitioner paid rent for space that was not used in the business. The Administrative Law Judge ordered the Division to recompute petitioner's liability by application of the rent factor to the rent indicated in the rent agreements introduced by petitioner.

The Administrative Law Judge determined that petitioner failed to show that his failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect. The Administrative Law Judge rejected petitioner's assertion that he properly relied on the advice of his accountant, finding that: petitioner made no attempt to ascertain the business's sales tax liability; petitioner never questioned his accountant as to which records should be maintained or how the sales tax returns were completed; and petitioner's careless record keeping, including the failure to maintain purchase invoices, guest checks and cash register tapes militated against a conclusion that petitioner's failure to comply with the Tax Law was due to reasonable cause and not due to willful neglect.

On exception, petitioner asserts that the Administrative Law Judge erred in determining that the use of the 1982 Dun and Bradstreet Index by the Division was a method reasonably calculated to estimate petitioner's tax liability. Petitioner asserts that "[t]he most destructive, most devastating, egregious blunder remains the confiscatory use of the Rent Percentage of 4.93% from the years 1976-1977 as applied to an audit period 12/1/81 through 5/31/85" (Petitioner's brief on exception). Petitioner asserts that a factor of 10 to 13 percent is accurate and is used in the pizza business.

The Division, on exception, asserts that petitioner did not satisfy his burden of showing by clear and convincing evidence that the audit methodology used in this case was erroneous

and that petitioner has failed to show that his failure to pay the proper amount of tax was due to reasonable cause and not willful neglect.

After reviewing the allegations presented to us on exception and the record before us, we find no basis for modifying the Administrative Law Judge's determination in any respect. The Administrative Law Judge adequately and correctly addressed the same allegations that are presented on exception to the Tribunal. Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated in his determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Giovan DiPiazza, Officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Giovan DiPiazza, Officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant is granted to the extent indicated in conclusions of law "H" and "J" of the Administrative Law Judge's determination but is otherwise denied; and
4. The Division of Taxation is directed to modify the Notice of Determination, dated December 20, 1985, issued to Giovan DiPiazza, Officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant in accordance with paragraph "3" above, but such Notice is otherwise sustained.

DATED: Troy, New York
December 27, 1991

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

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

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