

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petition :  
of :  
**OGGI RESTAURANT, 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 March 1, 1984 :  
through May 31, 1987. :

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Petitioner Oggi Restaurant, Inc., 1606 First Avenue, New York, New York 10028, filed an exception to the determination of the Administrative Law Judge issued on March 8, 1990 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 March 1, 1984 through May 31, 1987 (File No. 805142). Petitioner appeared by Morrison & Foerster (Arthur R. Rosen, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Lawrence A. Newman, Esq., of counsel).

Petitioner filed a brief on exception. The Division of Taxation filed a letter in lieu of a brief in opposition to the exception. Petitioner's request for oral argument was withdrawn.

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

***ISSUES***

I. Whether the Division of Taxation correctly concluded that petitioner had insufficient records for the audit period, thereby justifying the use of a markup to determine sales and use taxes due.

II. Whether the markup audit was reasonably calculated to reflect taxes due.

III. Whether petitioner has shown that its failure to comply with the Tax Law 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. These facts are set forth below.

Pursuant to a field audit which commenced in December 1986, the Division of Taxation, on January 20, 1988, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to Oggi Restaurant, Inc. ("petitioner") in the amount of \$60,811.82, plus penalty and interest, for a total amount due of \$92,936.88 for the period March 1, 1984 through May 31, 1987.

Previously, petitioner had executed consents extending the period of limitation for assessment of sales and use taxes as follows:

<u>Executed</u>	<u>Period</u>	<u>Date to Assess Tax</u>	<u>By</u>
12-29-86	12-1-83 through 2-28-84	6-20-87	Attorney
4-16-87	3-1-84 through 5-31-84	9-20-87	Attorney
7-21-87	3-1-84 through 8-31-84	12-20-87	Attorney
11-13-87	3-1-84 through 11-30-84	3-20-88	Vice-president

For the period at issue, petitioner operated a restaurant (primarily Italian cuisine) and bar located at 1606 1st Avenue (at 83rd Street) in New York City.

On December 12, 1986, the auditor sent an appointment letter to petitioner which requested all books and records pertaining to its sales tax liability for the period December 1, 1983 through November 30, 1986. The first quarter (December 1, 1983 through February 28, 1984) was subsequently withdrawn from this audit period since it had been included in a prior audit. The auditor met with petitioner's attorney and its accountant on a few occasions to review available records and to prepare markup schedules. On April 16, 1987, the auditor left with petitioner's attorney a revised list of items needed for future meetings (this list requested records through February 28, 1987). For the last quarter at issue herein (March 1, 1987 through May 31, 1987), a request for books and records was made orally to petitioner's attorney by the auditor.

The only records made available to the auditor were a general sales ledger, a cash disbursements journal and Federal income tax returns for 1984 through 1986. No cash register

tapes or guest checks were presented to the auditor. Petitioner's general sales ledger consisted of cash receipts and charge sales totals. Without the source documents, i.e., guest checks and cash register tapes, the auditor deemed petitioner's books and records to be inadequate. As a result thereof, the auditor chose to utilize petitioner's purchases per its records and to apply the food, beer and liquor markup percentages which had been calculated during a prior audit (March 1, 1981 through February 29, 1984). These markup percentages were 149 percent for food, 297.18 percent for beer and 382.17 percent for liquor. Applying these markup percentages to petitioner's purchases during the audit period resulted in adjusted sales of \$2,422,089.88 of food, \$174,635.56 of beer and \$1,161,666.72 of liquor (\$3,758,392.16 total adjusted sales). On its sales tax returns for the period, petitioner had reported taxable sales of \$3,021,277.00. The difference between adjusted and reported sales for the period was, therefore, determined to be \$737,115.16. The auditor then calculated a margin of error (\$737,115.16 divided by \$3,021,277.00) of 24.3974 percent which he used to determine additional taxable sales for each of the sales tax quarters at issue. By applying the appropriate sales tax rate (8¼ percent), additional tax due was determined to be \$60,811.82 for the audit period.

### ***OPINION***

The Administrative Law Judge concluded that: (1) petitioner's books and records were inadequate, thereby entitling the Division to resort to an audit method based on markup percentages to determine the correct amount of tax due herein, (2) petitioner failed to present sufficient evidence to prove that the audit method employed (application of markup percentages from a prior audit to petitioner's purchases during the audit period) resulted in an erroneous assessment, (3) petitioner failed to prove its entitlement to allowances for alcoholic beverages which were given or sold at reduced rates to customers and for food and alcoholic beverages which were consumed by petitioner's employees, and (4) petitioner did not prove that its failure to pay over the proper amount of sales tax was due to reasonable cause and not due to willful neglect.

On exception, petitioner asserts that: (1) it did not accept the use of markup figures from the prior audit, (2) the figures used by the auditor and upheld by the Administrative Law Judge failed to account for substantial amounts of food and beverages consumed by employees or given free of charge to customers, (3) the evidence introduced to establish that the owners of the corporation took steps to investigate the practices that were alleged to have been deficient, supported a conclusion that its failure to pay over the proper amount of the sales tax was not due to willful neglect, and (4) that this matter should be remanded to the Administrative Law Judge to allow the introduction of additional evidence to support an alternative markup method and allowances for alcoholic beverages and food consumed by petitioner's employees or given or sold at reduced rates to customers.

We affirm the determination of the Administrative Law Judge.

As a vendor of food, beer and liquor, petitioner was responsible for collecting sales tax on its retail sales (Tax Law § 1105[d][i]). Petitioner was also required to keep records of every sale and the tax due thereon, including "a true copy of each sales slip, invoice, receipt, statement or memorandum" (Tax Law § 1135[a]) upon which the sales "tax shall be stated, charged and shown separately on the first of such documents given to [the purchaser]" (Tax Law § 1132[a]).

Tax Law § 1138(a)(1) provides that where a sales tax return when filed states an incorrect or insufficient amount of tax due, the Division has the authority to determine, "from such information as may be available," the amount of tax actually due from the taxpayer for a given period. However, when the vendor maintains a comprehensive set of books and records, there can be no resort to external indices as a method of computing sales tax liability, because "the honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability" (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

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, 859) and thoroughly examine (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978, 979-80) 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, 828, lv denied 71 NY2d 806, 530 NYS2d 109). The request for records must be explicit and not "weak and casual" (Matter of Christ Cella, Inc. v. State Tax Commn., supra; Matter of Yel-Bom's Serv. Center, Tax Appeals Tribunal, May 10, 1990).

Where the Division follows this procedure, and thereby determines that the records are incomplete or inaccurate, the Division may apply external indices to estimate tax (Matter of Urban Liq. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139). Thus, the Division may resort to the use of an indirect audit method to determine the proper tax due where a taxpayer does not have the records necessary to verify taxable sales (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552). The estimate methodology utilized must be reasonably calculated to reflect taxes due (Matter of W.T. Grant Co. v. Joseph, 2 NY2d 207, 159 NYS2d 150, 157, 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, 177, affd 44 NY2d 684, 405 NYS2d 454; Matter of Cinelli, Tax Appeals Tribunal, September 14, 1989).

We concur in the determination of the Administrative Law Judge that petitioner's books and records were not adequate and that the Division's use of external indices to determine petitioner's liability was appropriate. The records provided by petitioner for the audit period consisted only of federal tax returns and a general ledger for sales and cash disbursements. No cash register tapes, guest checks or other original sales documents were provided during the audit or at the hearing. While the petitioner claims that it had guest checks for the audit period available for inspection, albeit in a flooded basement, it never presented these records or cash receipts during the audit or at the hearing. We, therefore, find that the Division's resort to external indices to estimate tax due was justified because petitioner presented insufficient records for the audit period to verify its taxable sales (Matter of Licata v. Chu, supra).

We next address whether petitioner has sustained its burden to demonstrate that the markup audit methodology employed by the Division was not reasonably calculated to reflect the tax due.

Petitioner claims that the Division's audit method, which consisted of the application of markup percentages from a prior audit of petitioner's business to the purchases of food and alcoholic beverages made during the present audit period, was totally arbitrary. In addition, petitioner contends that the auditor failed to substantiate the guidelines he utilized to corroborate the markup percentages he applied. Petitioner also asserts that the record below contained insufficient evidence of the Division's rational basis for the determination of petitioner's assessment and, therefore, this matter should be remanded to the Administrative Law Judge for admission of additional evidence and further testimony to describe the basis of the audit.

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, 453; 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. State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221).

We find that the Division's audit had a rational basis under the circumstances presented here. The record supports the conclusion that the auditor reasonably believed that petitioner, through its attorney and its accountant, had agreed to the use in this audit of the markup percentages from the sales tax audit of petitioner for the period immediately prior to this audit period. Under these circumstances, the auditor's failure to do more to justify the use of the markup percentages was not unreasonable. A taxpayer's agreement to use a particular methodology clearly supports the Division's use of it (Matter of Vebol Edibles, Tax Appeals Tribunal, January 12, 1989). At the hearing, petitioner's accountant did not deny that there had been an agreement to use the prior audit markup percentages for the present audit. At best, the

testimony supports a conclusion that the accountant is now confused as to what he agreed to with the Division. Although this matter might have been clarified by the attorney who represented petitioner at the hearing who was, according to the auditor, also present at the meeting at which the markup percentages were agreed to, petitioner's attorney did not testify.

The rationality of the Division's audit is further supported by the fact that petitioner did not even attempt at the hearing to challenge the clearly defined audit methodology that had been applied. The auditor used what records petitioner had for the audit period, petitioner's sales ledger and purchase journal, to determine the purchases. He then applied markup percentages from a sales tax audit for the period immediately prior to this audit period. Since the audit methodology and the origin of the figures used by the Division were clear, petitioner had specific audit findings to contest at the hearing. However, petitioner did not introduce any evidence at the hearing challenging the appropriateness or accuracy of the markup percentages. Instead, petitioner now seeks a remand so that it may now introduce alternative markup figures. The markup figures petitioner asserts should be used are figures that have allegedly been agreed to by petitioner's attorney and the City of New York in an audit of petitioner's New York City corporation taxes (Petitioner's Exhibit A, attached to brief). Petitioner had the opportunity to challenge the audit methodology at the hearing and introduce this evidence but it failed to do so. Petitioner's attempt to insert additional evidence into the record before the Tribunal is rejected and we will not consider it in our determination (Matter of Modern Refractories Serv. Corp., Tax Appeals Tribunal, December 15, 1988).

The Division of Taxation is only required to select an audit method reasonably calculated to reflect the tax due and then it is incumbent upon petitioner to establish that the method utilized results in an unreasonably inaccurate assessment or that the resulting assessment is erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679). In the present matter, petitioner failed at the hearing to present clear and convincing evidence which would indicate that the audit method employed resulted in an erroneous assessment. Petitioner cannot now bolster its claim that the Division's audit methodology was inadequate by attempting to introduce

additional evidence into the record before the Tribunal (Matter of Dubin, Tax Appeals Tribunal, April 21, 1988; Matter of Modern Refractories Serv. Corp., supra).

Petitioner's primary criticism of the audit concerns the auditor's failure to give allowances for food and alcoholic beverages consumed by employees or given free of charge to customers. The evidence offered by petitioner to show entitlement to the aforesaid allowances consisted of testimony by petitioner's accountant and certain reports of observations of employees apparently prepared by a private investigator. The accountant testified as to the amount and frequency of employee consumption of food and alcohol although the basis of his knowledge is unclear. Petitioner had the right to call restaurant employees or principals of the corporation to testify at the hearing in order to substantiate the allegation of substantial employee consumption, but failed to do so. As for the reports, this evidence is entitled to little or no weight as there was no proof as to the source and preparation of such reports.<sup>1</sup>

While it is possible that petitioner may be entitled to allowances, petitioner has the burden of proving entitlement and the correct amount for such allowances (Matter of Ristorante Puglia v. Chu, 102 AD2d 348, 478 NYS2d 91, 93). However, petitioner's only evidence in support of such allowances was the testimony of its accountant, and the reports previously discussed. The record shows that the accountant did not have direct knowledge as to the amount and worth of the food and alcoholic beverage allowances. He admittedly had not been to the restaurant since the beginning of the audit period. Moreover, his failure of recollection and admitted confusion as to the facts and the basis of his knowledge support the conclusion that his testimony cannot establish petitioner's entitlement to the amount of the allowances it seeks.<sup>2</sup> Based upon the record before us, we agree with the Administrative Law Judge that petitioner failed to sustain its

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<sup>1</sup>When the reports were introduced at the hearing, the accountant stated that he had not read the reports, did not know from whom the attorney received these reports, who had requested that they be prepared, or who had prepared them (Tr., pp. 42-47).

<sup>2</sup>For example, in response to a question from the Administrative Law Judge concerning the number of employees, the accountant indicated that he had "quite a few restaurants as clients, and it's not easy to remember each one individually" (Tr., p. 62).

burden of proof in order to substantiate the proper amounts which should be allowed for customer giveaways and for employee consumption of food and alcoholic beverages.

Finally, petitioner maintains that it has submitted sufficient proof to establish reasonable cause for its failure to pay the State the proper amount of sales tax due. The basis of this argument rests upon the reports allegedly prepared by the private investigation firm. If these reports can be found to be even slightly credible, they neither support nor disprove that petitioner's failure to pay the correct amount of sales tax was due to reasonable cause and not due to willful neglect. These reports were introduced by petitioner to support its position that additional tax was not due because extensive quantities of alcoholic beverages were being given away. Petitioner does not explain how these reports show that its failure to pay the correct amount of tax was due to reasonable cause other than to suggest that the existence of these reports show that petitioner was attempting to monitor its business practices. Petitioner's bare allegation that it was trying to improve deficient practices apparently identified during the prior audit is clearly insufficient to prove reasonable cause. Accordingly, the penalties and interest assessed by the Division are sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner Oggi Restaurant, Inc. is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Oggi Restaurant, Inc. is denied; and

4. The notice of determination and demand issued on January 20, 1988 is sustained.

DATED: Troy, New York  
November 30, 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