STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
VINCENT BASILEO D/B/A MIMMO'S RESTAURANT & PIZZERIA	:	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 June 1, 1983 through August 31, 1986	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on May 31, 1990 with respect to the petition of Vincent Basileo d/b/a Mimmo's Restaurant and Pizzeria, 75 Maple Street, Farmingdale, New York 11735 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, 1983 through August 31, 1986 (File No. 805855). Petitioner appeared pro se. The Division of Taxation appeared by William F. Collins, Esq. (Irwin Levy, Esq., of counsel).

The Division of Taxation filed a letter in lieu of a brief on exception. Petitioner did not file a brief in response. The Division of Taxation's request for oral argument was denied.

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

ISSUE

Whether the audit methodology used by the Division of Taxation was unreasonable.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "3" which has been modified. We have also made additional findings of fact. The

Administrative Law Judge's findings of fact, the modified finding of fact and the additional findings of fact are set forth below.

Petitioner Vincent Basileo d/b/a Mimmo's Restaurant & Pizzeria operated a pizzeria and restaurant at 118 West Main Street, Bayshore, Suffolk County. The business began in 1980 as a pizza place which also sold hero sandwiches and soda. Petitioner obtained a liquor license in 1984 or 1985 when he attempted to expand his offerings so as to become more of arestaurant. The establishment seated 25 people. Petitioner's wife was the chef.

While the restaurant was on a main street, it had no parking and was on the wrong side of the street to get business from travelers heading towards the Fire Island ferry. It was one-half mile from the ferry and two newer restaurants had opened very near the ferry, thus limiting petitioner's business which eventually declined. Petitioner fell behind in his utility bills and his purchases were "collect on delivery." The restaurant went out of business in the fall of 1986 when petitioner sold the building. The building does not now include a restaurant.

The auditor requested that petitioner furnish guest checks and purchase invoices for June 1, 1983 to August 31, 1986. He also requested heating, utility and telephone bills for the same period.

In response the accountant, Pat Petro, C.P.A., of New Hyde Park, stated that petitioner did not keep guest checks since "all his sales are taxable, the guest checks are not important." He furnished figures for purchases for the audit period. These totalled $26,937.50 for food, $3,432.14 for wine, $1,584.02 for soda and $2,085.87 for beer. Mr. Petro advised petitioner to obtain the heating, utility and telephone bills from the companies involved. Petitioner submitted at the hearing gas and electric bills of $323.03 for November 1985, and $359.05 and $131.28 for December 1985.

Petitioner claims to have been robbed four times causing the loss or destruction of his business records. These thefts, however, do not appear to have been reported to the police.

We modify finding of fact "3" to read as follows:

> The auditor who performed the audit of petitioner and prepared the audit report was Charles Kinlan. Mr. Kinlan is no longer employed with the Department of Taxation and Finance and he did not testify at the hearing.[1]

We find as an additional finding of fact that:

> The witness presented by the Division of Taxation was Allen Teplitzky. Mr. Teplitzky was the auditor who supervised this case. However, he had no personal recollection of this specific audit of petitioner other than knowledge gleaned from Mr. Kinlan's audit report (Tr., pp.
>
> 15-22). Mr. Teplitzky testified to the audit methodology used in petitioner's audit by reading from the audit report.[2]

The audit workpapers show that the sales tax returns reported gross sales of $97,259.10. Taxable sales were the same.

Sales shown on petitioner's books were $108,990.72 or about 12% higher than reported on the returns, and for 1984 and 1985 were within one-half of one percent of the sales reported on the Federal income tax returns.

The auditor did not examine petitioner's bank deposits.

Petitioner had some purchase invoices but (in the opinion of the auditor) not enough to do a complete audit for the entire audit period and so they were not used.

The purchases per petitioner's books for 1984 and 1985 were reconciled with the purchases on the Federal income tax returns by amounts deemed to be used for personal consumption.

The auditor did not visit petitioner's premises while it was open for business. He did, in February 1987, look in the window but made no attempt to enter and inspect the premises. He saw posted in the window certain favorable restaurant reviews which petitioner admitted he had solicited.

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[1] The Administrative Law Judge's finding of fact "3" read as follows:

"The auditor did not testify at the hearing."

We modify this finding of fact to more accurately reflect the record.

[2] We find this additional fact to more fully reflect the record.

The auditor arrived at a figure for the total audited sales of petitioner by obtaining figures for two other restaurants each deemed to be comparable to petitioner's restaurant, one with audited sales of $395,709.88 and another with audited sales of $645,791.00 and averaging them. The result, less sales reported by petitioner, was $423,491.34. This was 435% more than petitioner had reported on his returns.

The identity of the two restaurants from which the determination in this case was derived has not been disclosed to the taxpayer. The details behind the computation of the sales of such restaurants is not in the record.

We find as an additional finding of fact that:

> In response to a question by the Administrative Law Judge as to the basis for the figures derived from the two comparable restaurants, Mr. Teplitzky testified:
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> "I didn't take them. Mr. Kinlan took them. He would have taken them to two other Italian restaurants that would have been on main roads. Main Street is Montauk Highway, 27A."
>
> The Administrative Law Judge then asked him if he wanted to name these restaurants, to which Mr. Teplitzky testified:
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> "I don't know the names of the restaurants because we don't put that in our work papers . . . " (Tr., pp. 64-65).
>
> With respect to the use of the other restaurants, the audit report states simply "[w]e found it necessary to use outside indices. Analysis was made of other similar restaurant audits" (Exhibit C). The audit report does not provide any description of the audits performed on the other restaurants.[3]

A Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period June 1, 1983 through August 31, 1986 was issued on May 6, 1987 to petitioner for tax due of $31,432.25, penalty under Tax Law § 1145(a)(1)(i) of $7,563.58 and interest of $9,077.16 for a total amount due of $48,072.99.

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[3] We find this additional fact to more accurately reflect the record.

Another notice was issued the same day for the period June 1, 1985 through August 31, 1986 for penalties under Tax Law § 1145(a)(1)(vi) for omission of 25% of taxes required to be shown on the tax return and amounted to $1,358.59.

A consent extending the period of limitation to September 20, 1987 for the period June 1, 1983 through May 31, 1984 was executed by petitioner on August 29, 1986.

OPINION

In his determination below, the Administrative Law Judge found that the calculation of tax due was arbitrary and capricious. The Administrative Law Judge based his determination on the fact that the identity of the two comparable restaurants, as well as the calculations behind the figures derived, was not disclosed.

On exception, the Division of Taxation (hereinafter the "Division") argues that because petitioner's books and records were inadequate, the auditor was entitled to estimate taxes due by utilizing a comparison to other restaurants. Furthermore, the Division contends that Tax Law § 1146(c) prohibits it from divulging or disclosing any particulars set forth in tax returns or audit reports. The Division alleges that "[p]etitioner was not prejudiced by our legitimate refusal to divulge the taxpayers names" (Division's exception, Part 5, p. 2). Lastly, the Division requests that the determination of the Administrative Law Judge either be remanded to the hearing calendar, or that it be reversed.

We uphold the determination of the Administrative Law Judge for the reasons stated below.

Where, as here, the records of the taxpayer are insufficient or inadequate to permit an exact computation of the sales and use tax due, the Division is authorized to estimate the tax liability on the basis of external indices (Tax Law § 1138[a][1]; see, Matter of Ristorante Puglia v. Chu, 102 AD2d 348, 478 NYS2d 91, 93; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451, 452). The methodology selected must be reasonably calculated to reflect the taxes due (Matter of Ristorante Puglia v. Chu, supra; Matter of W.T. Grant Co. v. Joseph, 2 NY2d 196, 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 Lefkowitz, Tax Appeals Tribunal, May 30, 1990). While it is true that "considerable latitude is given an auditor's method of estimating sales under such circumstances as exist" in each case (Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221), certain limitations have been placed on this principle. It is necessary that the record contain sufficient evidence to allow the trier of fact to determine whether the audit has a rational basis (Matter of Grecian Sq. v. New York State Tax Commn., supra) and, further, that the record contain specific information identifying the external index employed by the Division in estimating the taxpayer's liability (Matter of Fashana, Tax Appeals Tribunal, September 21, 1989). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, supra).

The record is clear in this case that the resort to an external index was proper since petitioner's records were clearly insufficient and inadequate. The issue before us is whether the external index chosen by the Division is supported by a rational basis.

The audit methodology employed by the Division in this case was purportedly a comparison of petitioner's restaurant to two other "substantially and materially similar" (Division's exception, Part 5, p. 2) restaurants. The amount of tax due in this case was calculated as an average of the audited sales of the two other restaurants. However, the record is void of any evidence that describes any aspect of these two restaurants. Thus, the record does not provide any basis to evaluate the comparison between petitioner's restaurant and the two other restaurants utilized by the Division. In addition, the record does not indicate what kind of audit was performed of the other two restaurants. Contrary to the Division's suggestion, Exhibit K does not describe the audits performed of the other two restaurants. This Exhibit simply states the total audited taxable sales determined for each of the two restaurants. The derivation of these numbers is not explained.

Primarily, the Division argues that it can legitimately refuse to divulge taxpayers' names. Further, it argues that "[Tax Law] § 1146(c) [sic] states that it is unlawful for any officer or employee of the Department of Taxation and Finance to divulge or make known any particulars set forth in returns or reports" (Division's letter in lieu of brief, p. 3).

This argument is completely without merit. The Division's witness was asked to explain the similarities between the two restaurants and petitioner's restaurant. He was not asked to divulge any privileged information written on their respective tax returns or in their audit reports. Furthermore, the failure to name the other restaurants is not material to this case. What is material is the Division's inability, on direct examination, cross examination or examination by the Administrative Law Judge, to describe the other two restaurants or the audit performed on these restaurants.[4]

At the hearing below, the Administrative Law Judge asked Mr. Teplitzky to state the basis for the sales figures derived from the other two restaurants. Mr. Teplitzky responded that he could not testify as to the basis for the figures because he did not take them, but Mr. Kinlan did (the former Division auditor who was assigned petitioner's case) (Tr., pp. 64-65). As set forth in the facts, Mr. Teplitzky went on to state only what he thought the auditor would have done in obtaining the figures. Mr. Teplitzky further stated that the audit report, from which he continuously referred to when responding to questions while on the witness stand, does not state the names of the restaurants, but only the case numbers of the restaurants. Additionally, during direct examination, Mr. Teplitzky was asked how the audit was prepared, to which he responded:

> "We went into our files and Mr. Kinlan pulled out two cases that were as close to the type of this audit as possible, that he felt reflected what knowledge he had about the type of business and was as close as we

[4]"The administrative law judge may, where the record appears unclear, ask questions of the parties or of witnesses for the purpose of clarifying the record" (20 NYCRR 3000.10[d][1]). The basis for the audit methodology utilized was unclear. Therefore, we find that the Administrative Law Judge properly questioned the Division's witness concerning the nature of the audit performed, especially since petitioner was appearing pro se (see, Highfill v. Bowen, 832 F2d 112 [where the court stated that the Administrative Law Judge had a duty to develop the facts fully and fairly, particularly when the claimant is not represented by counsel]; Driggins v. Harris, 657 F2d 187).

> humanly possible [sic] could get to the business that Mr. Basileo was running" (Tr., p. 27).

Furthermore, petitioner questioned Mr. Teplitzky on cross examination concerning the Division's basis for the figures it used (Tr., pp. 54-57). Petitioner continually asserted throughout the hearing that the area in which its restaurant was located was depressed. Accordingly, petitioner asked Mr. Teplitzky if he had ever visited Bay Shore where petitioner's restaurant was located. Mr. Teplitzky responded that the area was not depressed. Petitioner continued to ask Mr. Teplitzky to explain how the sales figures used by the Division were relevant to petitioner's restaurant, but Mr. Teplitzky never directly responded (cf., Matter of Pizza Works, Tax Appeals Tribunal, March 21, 1991 [where the petitioner did not attempt to show that the office experience relied on by the auditor was not comparable to petitioner's business, but rather testified to its own test which resulted in different figures than that of the auditor]).

The record is clear that Mr. Teplitzky had no knowledge concerning the two restaurants used by the Division in this case nor of the audit performed on these restaurants. His testimony does not describe what Mr. Kinlan did and why he did it, but instead only describes what Mr. Teplitzky believes Mr. Kinlan would have done. Since Mr. Teplitzky's testimony does not describe any of the facts of the audits of the other two restaurants, it does not provide any basis to determine the rationality of the audit of petitioner. Further, these facts are not disclosed elsewhere in the record.

We have held that the record must contain information identifying the external index used by the Division to establish a rational basis for the audit methodology employed (see, Matter of Fashana, supra). We also conclude that the Division must at hearing, through witnesses or documents, be able to respond meaningfully to inquiries regarding the nature of the audit performed. Such information is necessary in order to provide petitioner with an opportunity to meet its burden of proving such methodology unreasonable (Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991). Since the Division was unable to provide such responses at

this hearing, we conclude that the audit is without rational basis and the taxpayer sustained its burden to show that the audit methodology was unreasonable.

Finally, a remand of this case would not be appropriate because the Division has had ample opportunity, through the repeated questions posed at the hearing, to describe the specifics of the instant audit and has simply been unable to do so (see, Matter of Shop Rite Wines & Liqs., Tax Appeals Tribunal, February 22, 1991).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The determination of the Administrative Law Judge is sustained;
3. The petition of Vincent Basileo d/b/a Mimmo's Restaurant & Pizzeria is granted; and
4. The notices of determination of sales and use tax due issued May 6, 1987 are cancelled.

DATED: Troy, New York
May 9, 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