

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
COMMACK FISH & SEAFOOD RESTAURANT CORP. :
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, 1984 :
through May 31, 1987 :
:

In the Matter of the Petition :
of :
ANTHONY ANNUNZIATO, OFFICER OF : **DECISION**
COMMACK FISH & SEAFOOD RESTAURANT CORP. : **DTA Nos. 806457,**
: **806458, 806459**
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, 1984 :
through May 31, 1987 :
:

In the Matter of the Petition :
of :
KATHLEEN ANNUNZIATO, OFFICER OF :
COMMACK FISH & SEAFOOD RESTAURANT CORP. :
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, 1984 :
through May 31, 1987 :
:

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on February 14, 1991 with respect to the petitions of Commack Fish & Seafood Restaurant Corp., Anthony Annunziato and Kathleen Annunziato, as officers, 116 Commack Road, Commack, New York 11725 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, 1984 through

May 31, 1987. The Division of Taxation appeared by William F. Collins, Esq. (Anne W. Murphy, Esq., of counsel). Petitioners appeared by Douglas A. Durnin, Esq.

The Division of Taxation filed a brief on exception. Petitioners did not respond. 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 Administrative Law Judge properly recalculated the notices of determination and demand for payment of sales and use taxes due.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "11," "17" and "18" which have been modified. As well, for purposes of organization and logic, we have moved finding of fact "16" closer to the beginning of the findings of fact because it necessarily precedes later findings of fact. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner Commack Fish & Seafood Restaurant Corp. (the "restaurant") was an establishment comprised of two departments. On one side of the restaurant, petitioners sold raw fish. This side contained lobster tanks and a case for the display of fish. The restaurant sold prepared food on the other side of the store. This department contained 14 tables located in close proximity to each other.

There was a separate cash register for each side of the restaurant. The restaurant was open six days a week and had two or three waiters or waitresses working on the premises.

In 1984, the restaurant sold prepared food two days a week. In 1985, the restaurant sold prepared food three days a week, and in 1986 sales of prepared food increased to four days a week. In 1987, the restaurant sold prepared food six days a week.

Early in 1987, petitioners remodeled the kitchen by installing a broiler and a steam table. The restaurant also stopped using disposable plastic dishes and began using dishes which were reusable. Prepared food sales increased after the renovations.

Petitioner Anthony Annunziato purchased the restaurant in 1981 for \$75,000.00. At that time, he paid \$15,000.00 in cash and borrowed the balance. During the period in issue, the outstanding stock of the restaurant was held by Anthony Annunziato and Kathleen Annunziato. Anthony Annunziato served as president of the corporation and Kathleen Annunziato was the corporation's vice-president and secretary.

In a letter dated January 14, 1987, the Division of Taxation (hereinafter the "Division") advised the restaurant that it was planning an examination of the restaurant's sales tax returns. The letter requested that petitioners make available all books and records pertaining to the restaurant's sales tax liability during the period of the audit, including journals, ledgers, sales invoices, purchase invoices, cash register tapes and exemption certificates.

After the foregoing letter was sent, the Division made an appointment with the restaurant's accountant to examine the books and records. During the meeting which followed, some records were made available for examination such as a ledger of cash receipts for 1984, 1985 and 1986. Some records for 1987 were also presented. However, the auditor learned that, as of the date of that meeting, the cash receipts journal had not been prepared for 1987 and that petitioners did not retain their guest checks or cash register tapes.

In order to calculate the amount of sales and use taxes due, the Division decided to conduct an observation test. On Friday, June 12, 1987, an auditor positioned herself near one of the restaurant's cash registers and recorded the restaurant's sales from 11:00 A.M. until 7:30 P.M. During this period of time, the Division observed taxable sales of \$2,048.00. The Division then divided this amount by petitioners' average taxable receipts per books of \$526.00 on Fridays during June, July and August of 1986 in order to calculate an error rate of 289.35%. The reported taxable sales during the audit period were then multiplied by the error rate resulting in audited taxable sales of \$515,188.00. This amount was then reduced by reported

taxable sales during the audit period of \$132,320.00 resulting in additional sales subject to sales and use tax of \$382,868.00.

The Division also found that, as of July 5, 1985, the restaurant did not pay tax on its gas and electric utility bills. An engineer's report, which was made available to the Division, concluded that 75% of the electricity was used for production. The Division accepted this percentage and determined that tax was due on 25% of the electric utility bills. It also determined that tax was due on 100% of the gas utility bills for the period June 1, 1984 through May 31, 1987. On the basis of the foregoing audit, the Division issued two notices of determination and demands for payment of sales and use taxes due, dated September 18, 1987, to the restaurant. The first notice assessed sales and use taxes for the period June 1, 1984 through May 31, 1987 in the amount of \$29,124.22, plus penalty of \$4,967.10 and interest of \$5,044.88, for a total amount due of \$39,136.20. The second notice assessed a penalty pursuant to Tax Law § 1145 in the amount of \$2,303.02.

The Division also issued notices of determination and demands for payment of sales and use taxes due to Anthony Annunziato and Kathleen Annunziato, as officers of the restaurant. These notices, which were also dated September 18, 1987, assessed the same amount of tax, penalty and interest which had been assessed against the restaurant. The notices which assessed tax explained that the individual petitioners were liable as responsible officers of the restaurant pursuant to sections 1131(1) and 1133 of the Tax Law.

We modify finding of fact "11" to read as follows:

After the assessments were issued, a Conciliation Conference was held before the Bureau of Conciliation and Mediation Services on July 12, 1988. At this conference, petitioners presented the restaurant's cash receipts journal for the period February 1987 through June 1987. Using those records, petitioners' taxable receipts on Fridays during the period February 1, 1987 through May 31, 1987 were totalled and then divided by the number of Fridays in that period to calculate average taxable receipts of \$612.00 for the period. This was then divided by \$1,933.00 which represents the taxable receipts for the observation conducted on Friday,

June 12, 1987.¹ The resultant error rate from this calculation was 215.85%. On the basis of the revised error ratio, the additional tax due on petitioners' taxable sales was reduced to \$21,342.86."²

After the audit was conducted, petitioners complained that the assessment was too great because the audit methodology did not take into account the fact that petitioners had expanded the kitchen. The Division chose not to give this argument any credence because petitioners were unable to show that they had increased the number of tables available for serving customers after the renovation and because the Division did not observe a marked increase in utility usage.

Mr. Annunziato left school at the age of 14 and, at the time of the audit, he did not know how to read or write.

Mr. Annunziato did know how to write numbers and how to add. In 1984, he kept the records for the store. In practice, Mr. Annunziato used his cash registers to obtain a total of the sales of fresh fish and prepared food. These amounts were then recorded in a black notebook.

Once a month, Mr. Annunziato gave the notebook to his accountant and, when the accountant was finished with the notebook, it was returned to Mr. Annunziato. At the end of the year, when Mr. Annunziato was finished with the notebook, he gave the book to his children as a scribbling pad. Mr. Annunziato's accountant never told him to save the notebook or cash register tapes and Mr. Annunziato did not realize that it was necessary to save these items.

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It is noted that this latter figure was substituted for the original observation test sales figure derived, \$2,048.00, which was reduced in order to eliminate sales taxes charged.

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The Administrative Law Judge's finding of fact "11" read as follows:

"After the assessments were issued, a conference was held wherein petitioners presented the restaurant's cash receipts journal for the period February 1987 through June 1987. Using those records, petitioners' taxable receipts on Fridays during the period February 1, 1987 through May 31, 1987 were totalled and then divided by the number of Fridays in that period to calculate average taxable receipts of \$612.00. The average taxable receipts were then divided by \$1,933.00, the sales on June 12, 1987 per petitioners' books, to calculate an error ratio of 215.85%. On the basis of the revised error ratio, the additional tax due on petitioners' taxable sales was reduced to \$21,342.86."

Finding of fact "11" has been modified to accurately reflect the derivation of the taxable sales figure used in calculating the error rate.

We modify finding of fact "17" to read as follows:

Petitioners testified that sales of prepared food increased during the warmer periods of the year and during hot days by 30 to 40 percent, while sales of fresh fish declined during these periods. However, petitioners' taxable sales reported on the restaurant's returns contradict the testimony regarding the warmer periods of the year, and as for the 30 to 40 percent increase in sales on hot days, petitioners submitted no proof to support this claim.³

We modify finding of fact "18" to read as follows:

Petitioners testified that the Friday on which the observation test was conducted was a sunny, hot day and the restaurant was busier than normal. The auditor testified that it was an average sunny day, and that she did not think that it rained on that day. The auditor's log created during the observation contains a note that it was raining at midday, approximately the time she began the audit. No other evidence regarding the weather that day was submitted.⁴

In 1986, the restaurant's records were maintained by Mrs. Annunziato. It was Mrs. Annunziato's practice to record the sales figures obtained from the cash register in a notebook. At the end of a week, the figures were placed in a ledger. Once a month, the sales figures were given to an accountant for the preparation of sales tax returns. The sales and use tax returns, which were subsequently prepared by the accountant, were reviewed by Mrs. Annunziato and signed by Mr. Annunziato.

3

The Administrative Law Judge's finding of fact "17" read as follows:

"It is petitioners' experience that on warm days the sales of prepared food increased. Similarly, sales of prepared food increased during the warmer periods of the year. Fresh fish sales declined as prepared food sales increased."

We modified finding of fact "17" because we found the documentary evidence contrary to the Administrative Law Judge's determination regarding increased sales.

4

The Administrative Law Judge's finding of fact "18" read as follows:

"The Friday on which the observation test was conducted was a sunny, hot day and the restaurant was busier than normal."

We modified finding of fact "18" to reflect the fact that petitioners alleged, rather than proved, that the day of the observation was a sunny, hot day.

The increase in prepared food sales during the audit period was not reflected in marked increased electricity usage because petitioners began trying to save electricity by shutting down their compressor and buying better equipment.

According to the restaurant's records, sales of prepared food during the period February 1987 through June 1987 were as follows:

February	\$ 7,880.00
March	8,477.00
April	8,258.00
May	8,808.00
June	15,314.00

According to the restaurant's records, sales of prepared food on Fridays during June 1987 were as follows:

June 5, 1987	\$1,248.00
June 12, 1987	1,933.00
June 19, 1987	1,677.00
June 26, 1987	1,698.00

OPINION

The Administrative Law Judge, focusing on the post-assessment adjustments to the notices of determination, rejected as meritless petitioners' arguments that because the observation was done on a Friday (which petitioners' records show to be their busiest day of the week), and because the auditor failed to account for increases in sales due to restaurant renovations, the assessment was excessive. The Administrative Law Judge reached this conclusion based on the facts that the assessment was calculated by comparing observation day sales only to sales on other Fridays, and because the modified error rate was not derived from sales information for periods prior to the renovations.

However, the Administrative Law Judge determined that in making the post-assessment adjustments to the notices, the Division improperly utilized sales figures gleaned from petitioners' records, rather than from the observation test, and further, that the Division used an error rate in its adjusted calculation which was "improperly inflated" because it was based on a comparison of summer sales to sales in the winter and spring, without allowing for any seasonal impact on sales. Therefore, the Administrative Law Judge directed the Division to recompute

the error rate by comparing the results of the observation test to the sales of prepared foods on the average Friday during the month the observation test was conducted.

Pending modification of the assessment pursuant to this recomputed error rate, the Administrative Law Judge sustained the notices of determination and demand for payment of sales and use taxes due.

On exception, the Division asserts that the sales and use taxes due for the audit period, as reflected in the conciliation orders, should be sustained. The Division maintains that conciliation conference proceedings are in the nature of settlement negotiations, the substance of which may not be used to the disadvantage of either party in any future proceedings. In this vein, the Division contends, it was an error for the Administrative Law Judge to "delve the substance" of the conciliation conference proceedings to find, as the sole basis for a redetermination of the assessment, that the methodology used during the conciliation proceedings was erroneous (Division's brief, pp. 17-19). In any case, the Division argues, as the Administrative Law Judge found neither the original assessments nor the methodology used in their calculation to be erroneous, if the post-assessment adjustments were made in accordance with the original audit methodology (in light of the additional information provided by petitioners at the conference), then these adjustments should not be at issue, and the assessments, as adjusted, should be sustained (see, Division's brief, pp. 9, 18, 19).

Further, even if the post-assessment adjustments were properly at issue here, the Division urges, the sales figure used in the adjustment -- contrary to the Administrative Law Judge's assertions -- was derived from the observation test itself. In addition, claims the Division, the adjusted error rate, based on a comparison of the observation day (June 12, 1987) sales to petitioners' sales records from February through May of that year, was properly derived for the following reasons: 1) these records are much closer in time to the observation date than were the sales records from June through August of 1986 which were used in the original calculation; and 2) since petitioners did not prove that sales were affected by seasonal change, there is nothing improper about comparing June sales to sales in February, March, April, and May.

Because the Administrative Law Judge determined that the original assessment was rationally based, argues the Division,⁵ the real issue here is whether petitioners have sustained their burden of proving the assessments incorrect. Since petitioners have not done so, the Division asserts, the revised assessments should be sustained.

We reverse the determination of the Administrative Law Judge and sustain the notices of determination as adjusted.

The Administrative Law Judge's determination hinges on his conclusion that the restaurant's sales of prepared foods increased during the summer months and on hot days in particular (see, Determination, p. 9), and that, therefore, a comparison of sales on a warm Friday in June to an average of sales on a Friday from February through May, necessarily results in an inflated error rate. The Administrative Law Judge apparently based this conclusion on his analysis of petitioners' records, as well as on the credibility of petitioners' testimony (see, Determination, p. 10 [where the Administrative Law Judge states that petitioners' records demonstrate an increase in sales during warm periods]).

Contrary to the Administrative Law Judge's reading of petitioners' records, we find that the records -- at least the restaurant's sales tax returns -- actually contradict a conclusion that sales of prepared foods increased during warm periods. The chart in Division's Exhibit B, entitled: "Summary of Sales & Use Tax Defeciency" [sic], shows taxable sales reported by petitioners for the twelve quarterly periods included in the audit. This chart does not indicate any instance, much less a pattern, of increased taxable sales during warm periods. Instead, the chart reveals that for the two quarters reported in 1984 (those ended August 31, 1984 and November 30, 1984), the sales for September through November were nearly \$1,300.00 greater than sales for June through August. In addition, the sales for the next quarter, that covering December 1984

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We note that the Administrative Law Judge never actually made this determination; in fact, based on his explanation for why the error rate used in the adjustment was not erroneous -- at least insofar as its taking into account renovations increasing sales -- he might well have found fault with the original assessment. This is because the original assessment was based on an error rate derived from a comparison of observation day sales to sales during a period prior to the renovations.

through February of 1985, show an increase of nearly \$150.00 over sales of September through November of 1984. Similarly, in 1985 (for which all four quarters are reported), sales were the highest for the winter months of December (1984) through February (1985), followed by the sales for September through November (reported at approximately \$1,000.00 less). The sales for June through August of 1985 are only third highest, at \$1,180.00 less than the sales for December (1984) through February (1985) of that year. As for 1986 (for which all four quarters are reported), sales were highest for the period March through May, with sales for June through August at \$635.00 less. For the final two quarters in the audit period (those ended February 28, 1987 and May 31, 1987), sales for March through May are nearly double those for December (1986) through February (1987), but this unprecedented increase, according to petitioners' testimony, was attributable to profitable restaurant renovations which began sometime in January of 1987.

In light of these findings, we cannot agree with the Administrative Law Judge's conclusion that petitioners' records show an increase in sales in the warmer months. Neither has a thorough examination of the evidence before this Tribunal produced any other proof to support such a conclusion, except for petitioners' own testimony, which, in the face of the contrary documentary evidence, we reject. Further, if the Administrative Law Judge based his conclusion on petitioners' records of sales on Fridays in June of 1987 (see, Determination, pp. 7, 9-10), as compared to sales in months just prior to it, we believe such reliance to be unfounded. The average Friday sales in June of 1987 is shown on petitioner's records as \$1,639.00. The average Friday sales from February through May of 1987 is shown as \$612.00.⁶ Compared to the observation day sales of \$1,933.00,⁷ the error rate derived using the June 1987 figures is

6

For purposes of comparison, the average Friday sales from June through August of 1986, used in the original assessment, was \$526.00.

⁷While the Administrative Law Judge rejected this figure, finding that it came from petitioners' records instead of the observation test and, therefore, used the original figure of \$2,048.00 in his computation, as we indicated in our modified finding of fact, we believe the record shows that the \$1,933.00 figure was derived by a proper elimination, from the observation day sales recorded, of the sales tax charged (see, Exhibit "B-11").

18%, while the error rate derived using the February through May 1987 figures is 215.84%.⁸ Such a sudden and drastic increase in the amount of sales recorded by petitioners during June of 1987 compared to the earlier months of 1987, considered in light of petitioners' tax returns which show lower sales in the summers than in other seasons, suggests to us that petitioners' method of recording sales may have improved in June of 1987. For this reason, we conclude that the actual pattern of the restaurant's sales cannot be determined based on the sales recorded for June of 1987.

It follows, then, that since we do not find that petitioners have proven that sales generally increased in the warmer months of the year, we find nothing irrational or unreasonable about the post-assessment adjustments which were derived from an error rate based on comparing June sales to sales in February through May.⁹

Based on our decision, discussion of other issues raised by the Division is unnecessary.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;
2. The determination of the Administrative Law Judge is reversed;
3. The petitions of Commack Fish & Seafood Restaurant Corp., Anthony Annunziato, and Kathleen Annunziato are denied; and

⁸For purposes of comparison, the error rate used in the original assessment was nearly 300%.

9

We note for the record our rejection of the Administrative Law Judge's assertion (see, Determination, p. 9, footnote 1) that, because in computing the original audit the Division relied on a comparison of observation day sales to sales in June through August of 1986, the Division had "implicitly accepted" the premise that prepared food sales increased as the weather became warmer. In the opinion of this Tribunal, this ascribes far too much meaning to the Division's actions here when not only was it merely logical for the Division to compare sales in a particular month to sales in that month or quarter during a previous year, but in this case it was necessary, as petitioners did not have available any sales records for 1987. At most, the Division chose June through August, instead of September through November, in case there were seasonal trends in sales, not necessarily because such seasonal trends had been established.

4. The notices of determination and demand for payment of sales and use taxes due, dated September 18, 1987, issued to Commack Fish & Seafood Restaurant Corp., Anthony Annunziato, and Kathleen Annunziato are sustained as adjusted pursuant to the conciliation order dated November 23, 1988.

DATED: Troy, New York
March 12, 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