STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition

of

BERNSTEIN-ON-ESSEX ST., INC.

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, 1984 through December 31, 1987.

In the Matter of the Petition

of

SOLOMON BERNSTEIN, OFFICER OF BERNSTEIN-ON-ESSEX ST., INC.

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, 1984 through December 31, 1987.

In the Matter of the Petition

of

RUTH BERNSTEIN, OFFICER OF BERNSTEIN-ON-ESSEX ST., INC.

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, 1984 through December 31, 1987.

DECISION
DTA NOS. 807165, 807166 AND 807167

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 27, 1991 with respect to the petitions of Bernstein-on-Essex St., Inc., Solomon Bernstein, Officer of Bernstein-on-Essex St., Inc. and Ruth Bernstein, Officer of Bernstein-on-Essex St., Inc., c/o Manheim, Kosson & Novick, 90 Millburn Avenue, Millburn, New Jersey 07041 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, 1984 through December 31, 1987. Petitioners appeared by Lawrence R. Cole & Associates (Lawrence R. Cole, C.P.A.). The Divisionof Taxation appeared by William F. Collins, Esq. (Mark F. Volk, Esq., of counsel).

The Division of Taxation filed a brief on exception. Petitioners filed a reply brief. The Division of Taxation filed a letter in response to petitioners' reply brief. Petitioners filed a letter in response. Oral argument, at the Division's request, was heard on June 25, 1992.

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

ISSUES

I. Whether, based upon the books and records provided to the auditor, the audit method employed by the Division of Taxation was reasonably calculated to reflect tax due and, if so, whether the results obtained therefrom have been shown by petitioners to be erroneous.

II. Whether omnibus penalty, asserted pursuant to Tax Law § 1145(a)(1)(vi), for omission of an amount which is in excess of 25% of the amount of sales and use taxes required to be shown on the return, should be assessed herein.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "10" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

On March 25, 1988, the Division of Taxation (hereinafter the "Division") issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner Bernstein-on-Essex St., Inc. in the amount of $437,802.38, plus penalty and interest, for a total amount due of $633,497.76 for the period December 1, 1984 through December 31, 1987. In addition, on the same date, the Division also issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to this petitioner assessing omnibus penalty (Tax Law

§ 1145[a][1][vi]) in the amount of $37,831.08 for the period June 1, 1985 through December 31, 1987.

On the same date, the Division issued two notices of determination and demands for payment of sales and use taxes due (in the identical amounts for the identical periods) to each of petitioners Solomon Bernstein and Ruth Bernstein, as officers of Bernstein-on-Essex St., Inc.

Solomon Bernstein and Ruth Bernstein do not contest the Division's determination that each was liable, pursuant to Tax Law §§ 1131(1) and 1133(a), for sales and use taxes due from the corporation. Therefore, all references hereinafter made to "petitioner" shall refer solely to Bernstein-on-Essex St., Inc.

Petitioner is a Glatt Kosher restaurant which commenced doing business on the lower east side of New York City approximately 60 years ago. It is an internationally-known restaurant and became a landmark for those people who observe the laws of Kashruth (Jewish dietary laws). In 1968, it began serving Kosher Chinese foods. There was both sit-down service as well as an over-the-counter part for take-out orders. During the audit period, petitioner had a large display freezer containing both Jewish and Chinese foods. Prices were posted for meats by the pound and for sandwiches.

Petitioner employed three or four people to serve take-out customers. The guest check books used by these employees were maintained separate and apart from the guest check books used by those who waited on tables. Both taxable and nontaxable items were sold at the take-out counter. The employees who worked at the take-out counter were instructed to write down, on the guest checks, the items sold, the price of the items and the tax charged, if any. However, in most instances, these employees failed to write the items sold on the guest checks and, if they did so, the writing was often illegible. An examination of the sales invoices revealed that tax was charged on all table sales, but only on about one-half of the counter sales.

This audit commenced in October 1987. An appointment letter was sent to petitioner on October 19, 1987 (the appointment was later changed and another letter was sent on November 10, 1987). This letter stated, in part, as follows:

> "All books and records pertaining to your Sales and Use Tax liability for the period under audit are to be available on the appointment date. This would include journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns and exemption certificates. Exemption certificates not made available may be disallowed in which case you will be held liable for the tax on the transaction."

The letter stated that the period under audit was December 1984 through August 1987. On February 23, 1988, the Division received notification of a bulk sale (the business was sold to Sidney Horn as of January 6, 1988) and, as a result thereof, the audit period was extended through December 31, 1987. The auditor orally requested records for the last quarter from petitioner's accountant.

The first meeting with petitioner's representative occurred in December 1987. At that time, petitioner's business was examined by the auditor and his team leader. A second examination was done on April 18, 1988, after the business had been sold to Mr. Horn.

Although the auditor initially requested books and records for the period referred to hereinabove, petitioner's accountant stated that, since the records were voluminous, it would take a great deal of time to assemble them. The auditor then requested sales invoices for the period June 1 through August 31, 1987. The accountant again stated that records for an entire quarter would be too voluminous, but that he could provide such records for a seven-day period. However, only two days of sales invoices (guest checks) were provided (October 22, 1986 and June 22, 1987). For the two days of guest checks provided, gaps (in excess of 40%) existed in the numerical sequence. Based upon the number of invoices missing and the average sale determined from the guest checks provided, a dollar value was assigned to the missing guest checks. Additional daily taxable sales were, therefore, determined to be $5,763.52 (or a percentage of additional sales of 29.5983%).

Gross sales per returns filed (through November 30, 1987) were $9,337,734.00. Gross sales for December 1987 were projected to be $259,382.00 ($9,337,734.00 divided by 36). Utilizing the guest check error percentage (29.5983%), audited taxable sales were determined to be $12,197,804.00. This amount included disallowed house account sales of $97,167.00 which consisted of sales to various organizations and religious groups. Since petitioner could not

show to the satisfaction of the auditor that the tax collected was actually related to the sales or was, in fact, remitted, tax ($8,016.20) was assessed thereon. In some instances, tax was assessed on the house accounts based upon petitioner's failure to present properly completed exemption certificates. Tax due on audited sales was determined to be $1,006,319.00. Tax reported for the period was $588,479.00. Additional tax due on sales (determined by applying an error rate of 71.0034% [$1,006,319.00 audited tax due - $588,479.00 tax reported = $417,840.00 additional tax due divided by $588,479.00 tax reported] to the tax reported for each quarter) was determined to be $417,840.10. Based upon the auditor's determination that petitioner's records (guest checks which failed to set forth the claimed nontaxable items sold) failed to properly substantiate claimed nontaxable sales, all sales were deemed taxable. The auditor did admit, however, that, based upon his examination of the business premises and the guest checks from over-the-counter sales, it seemed apparent that petitioner made nontaxable sales.

In addition to the $417,840.10 in tax due on sales, tax was assessed on overcollections ($5,922.47), recurring purchases ($2,366.78) and fixed assets ($11,673.03) for a total tax due of $437,802.38, which was the amount assessed per the notices of determination issued March 25, 1988 (see above). The assessment on overcollections resulted from the auditor's determination, after reviewing the two days' invoices presented, that petitioner had, in some instances, charged sales tax at a rate greater than the 8¼% which was in effect during the audit period. The assessments on recurring purchases and fixed assets resulted from an examination of one month's purchase records. The auditor testified that purchase invoices for just one month were provided despite the request for records for the entire audit period and that some invoices were missing for the one month examined.

After the issuance of the assessments, certain discussions between the auditor and petitioner's accountant took place. An appointment was made for a visit to the place where petitioner's records were stored (William Rosenfeld, petitioner's manager from 1968 until the sale of the business in 1988, testified that, after the sale, the records were stored in cartons at a

nearby synagogue). The auditor stated that he viewed the records which were stored in various boxes in a remote area and, when he requested records for specific periods, he was told that, since the records were not stored in any particular order, a great deal of time would be required to locate and assemble the records for such specific periods (the auditor stated that he was told that it would take at least one month to locate and assemble the records for any given seven-day period). As a result, the auditor did not attempt to utilize these records and no adjustments were made, at that time, to the assessment as issued.

A conciliation conference was held by the Bureau of Conciliation and Mediation Services on December 12, 1988 at which time petitioner's representative stated his disagreement with the audit findings as follows:

(a) all sales, including food sold in bulk at the deli counter, were deemed to be taxable;

(b) based upon an examination of two days' guest checks, the auditor determined that 40% of such checks were missing. As a result, petitioner's gross and, therefore, taxable sales were increased by 40%. The figure of 40% was arrived at by disallowing any invoices which were not in numerical order in the guest check book; and

(c) all credit card sales were disallowed even though tax was reported because, in the two-day test, no guest checks for credit card sales were observed.

As a result of the foregoing, the conferee directed petitioner's representative to supply the auditor with four days' guest checks and petitioner's cash receipts journal as well as any proof of nontaxable deli sales. The requested guest checks were furnished and it was determined that all were reported in the cash receipts journal. Nontaxable deli sales were not substantiated. Accordingly, total tax due was revised as follows:

Tax due on disallowed nontaxable sales	$181,827.28
Tax due on disallowed house account sales	8,016.20
Tax due on overcollections	5,922.47
Tax due on recurring purchases	2,366.78
Tax due on fixed assets	11,673.03
	$209,805.76

On July 7, 1989, conciliation orders were issued which recomputed total tax due from petitioner to $209,805.76, plus full penalty and statutory interest, and omnibus penalty was reduced to $18,221.88. Corresponding conciliation orders were also issued which made identical recomputations of tax and omnibus penalties due from Solomon Bernstein and Ruth Bernstein, as officers of petitioner.

Tax due on disallowed nontaxable and house account sales ($181,827.28 + $8,016.20 = $189,843.48) was recomputed as follows:

(a) the disallowed house account percentage of 37.36%, computed by the auditor based upon his inability to verify that sales tax was paid over on these sales, was unchanged. Total disallowed house account sales were, therefore, determined by both the auditor and the conferee to be $97,166.64 for the audit period;

(b) gross and taxable sales, including the amount thereof projected for the month of December 1987, remained unchanged. The conferee did not, however, increase gross sales as did the auditor who utilized a guest check error percentage of 29.5983% to increase gross and taxable sales by $2,763,603.30. As a result, audited taxable sales (including disallowed house account sales) were determined to be $9,434,200.00. By subtracting reported taxable sales of $7,133,133.00, additional taxable sales were found to be $2,301,067.00. The percentage of increase was, therefore, 32.25885% ($2,301,067.00 divided by $7,133,133.00). By applying this percentage to taxable sales reported for each quarter, additional tax due was $189,843.48;

(c) claimed credit card sales which were disallowed by the auditor (see, above) were allowed by the conferee;

(d) tax due ($2,366.78) on recurring purchases was unchanged; and

(e) tax due ($11,673.03) on fixed asset acquisitions was unchanged.

Subsequent to the conciliation conference, petitioner furnished additional documentation to the auditor which resulted in an additional adjustment, i.e., tax due on fixed asset acquisitions was reduced from $11,673.03 to $1,393.51. Total tax due is, therefore, reduced to $199,526.24.

We modify finding of fact "10" of the Administrative Law Judge's determination to read as follows:

> The audit report, on pages one and three, reveals that the auditor spent approximately 16.25 hours reviewing the file of a prior audit conducted on petitioner's business. Such audit file evidenced that petitioner had nontaxable sales.[1]

In his review of the two days' guest checks provided (see above), the auditor saw some guest checks for sales in the $200.00 to $500.00 range. The average sale per guest check was determined to be $23.24.

The auditor determined that of petitioner's total gross sales, 97.29% result from guest check sales (2.71% were house account sales).

The new owner of Bernstein-on-Essex Street (see above), Sidney Horn, stated in a letter, the content of which was sworn to on March 7, 1989, that, with the exception of the installation of a computerized food tracking

and cash register system, the business was being operated in a manner which was identical to its operation prior to the sale. William Rosenfeld, who was an employee of Bernstein-on-Essex Street from 1960 through June 1988 (he was the manager from 1968 through June 1988), testified that the business did not change after its sale in January 1988.

As indicated above, the Division received a bulk sale notification on February 23, 1988. The auditor testified that, as a result thereof, he had to issue an assessment on or before March 26, 1988 (the assessments were issued on March 25, 1988).

The auditor testified that an observation test could not be performed because of the change in ownership of the business in January 1988. He stated that this was the case because it could not be ascertained whether or not the business had changed after its sale. He further

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[1] Finding of fact "10" of the Administrative Law Judge's determination read as follows:

> "The audit report states that the auditor spent approximately seven hours reviewing the file of a prior audit conducted on petitioner's business. Such audit file revealed that petitioner had nontaxable sales."

We modified the Administrative Law Judge's finding of fact to more accurately reflect the record.

testified that, in his experience as a sales tax auditor (12 years), observation tests were utilized, in some instances, even after a sale of a business.

OPINION

The Administrative Law Judge determined that the auditor properly concluded that petitioner's books and records were not in auditable form and were inadequate to perform a detailed audit. Therefore, the Administrative Law Judge held that the auditor's resort to external indices to assess tax was proper. Further, after determining that petitioner had not sustained its burden of proving that the Division's assessments of taxes on overcollections, recurring purchases and fixed asset acquisitions were erroneous, the Administrative Law Judge sustained the assessments, as well as the Division's assessment on house account sales.

However, finding that "[t]he evidence presented at the hearing . . . indicate[d] that it was patently obvious that at least a portion of petitioner's sales were of the nontaxable variety" (Determination, p. 14), the Administrative Law Judge held that it was not reasonable for the Division to deem all of petitioner's sales taxable. The Administrative Law Judge explained that it is the totality of the circumstances which must be considered in determining whether or not an audit method is reasonable, noting that when the key issues revolve around the existence and amount of nontaxable sales, it is not reasonable to deem all sales taxable when the evidence clearly indicates otherwise.

The Administrative Law Judge rejected the Division's utilization of Matter of Reference Lib. Guild (Tax Appeals Tribunal, August 4, 1988) to support its position that it was reasonable to declare all petitioner's sales taxable, distinguishing the facts of Reference Lib. Guild from those present here.

In view of the complete lack of information in the record regarding the percentage of total sales attributable to over-the-counter sales, the Administrative Law Judge held that a recalculation of taxable versus nontaxable sales would be impossible and, therefore, cancelled in full the portion of the assessment pertaining to disallowed nontaxable sales. In addition, the Administrative Law Judge cancelled the omnibus penalty imposed under Tax Law

§ 1145(a)(1)(vi), as cancellation of the portion of the assessment regarding disallowed nontaxable sales rendered the omnibus penalty inapplicable.

On exception, the Division argues that the Administrative Law Judge erred in cancelling the portion of the assessment pertaining to tax due on disallowed nontaxable sales, since under Tax Law § 1132(c), all of petitioner's receipts are presumed taxable until the contrary is established by petitioner, i.e., petitioner has the burden of proving the existence and amount of nontaxable sales, and petitioner has failed to refute this presumption despite several opportunities to do so.

The Division insists that the Administrative Law Judge should not have attached such significance to the admission by the auditor that petitioner had some degree of nontaxable sales, since this admission is not sufficient to refute the presumption of taxability. Rather, claims the Division, it is petitioner's burden to prove which particular receipts are nontaxable through "documentation confirming the existence and accuracy of the allegedly [nontaxable] sale" (Exception, attached rider, p. 2, citing, Matter of On the Rox Liqs., Ltd. v. State Tax Commn., 124 AD2d 402, 507 NYS2d 503, lv denied 69 NY2d 603, 512 NYS2d 1026).

The Division contends that, given petitioner's "patently inadequate records" which do not identify nontaxable sales, petitioner has failed to meet its burden (Division's brief on exception, pp. 7-8). The Division stresses that petitioner "cannot shift its duty to prove non-taxable [sic] sales and to maintain sufficient records to the Division" (Division's brief on exception, p. 9), for it is not the burden of the Division to prove that each of petitioner's receipts are in fact taxable (Exception, attached rider, p. 2, quoting, Matter of Dacs Trucking Corp., Tax Appeals Tribunal, March 21, 1991).

In addition to its request to sustain the assessment regarding the tax on disallowed nontaxable sales, the Division asks that the imposition of omnibus penalties, while reduced in accordance with the Administrative Law Judge's finding of fact "8," be otherwise sustained.

Finally, the Division, in a letter to the Secretary to the Tribunal, asserts that petitioner's reply brief, which the Division contends is in the nature of an exception, should be dismissed as an untimely exception.

In response, petitioner agrees with the Administrative Law Judge's ruling insofar as it concerns the cancellation of the portion of the assessment relating to disallowed nontaxable sales, however, petitioner requests that the Tribunal "amend the Determination to limit the assessment to only the periods tested as they relate to expenses, over/undercollections and house account receivables -- with no penalty and simple interest due to reasonable cause" (Petitioner's reply brief, p. 10). Petitioner asserts that there was no basis for projecting the test period results because the books and records were deemed adequate and no test period agreement was signed. Petitioner agrees to pay the revised tax due on fixed assets.

Additionally, petitioner asks that the assessment be limited to the initial audit period through August 1987. Petitioner claims that, since no additional audit work was performed, there is no basis for the Division's projection of the test period results through December 1987.

Further, petitioner claims that, by neglecting to address the issue of the reasonableness of its audit method, the Division impliedly agrees with the Administrative Law Judge's determination that nontaxable counter sales were properly allowed.

In response to the Division's letter to the Secretary to the Tribunal regarding petitioner's reply brief, petitioner, in its letter to the Secretary to the Tribunal, disputes the Division's allegation that petitioner has filed an untimely exception rather than a timely reply brief. Petitioner explains that since the Division took exception to the Administrative Law Judge's issue "I" regarding the audit method of the Division and the results obtained therefrom, as well as conclusions of law "C" and "D," and issue "I" encompasses the entire determination (exclusive of the discussion of an omnibus penalty), and conclusions of law "C" and "D" pertain to the entire assessment (inclusive of issue "I"), petitioner's reply brief merely addresses the same exceptions taken by the Division.

Finally, petitioner asks that, should the Tribunal sustain the Administrative Law Judge's cancellation of the assessment on disallowed nontaxable sales and the omnibus penalty, the Tribunal should also cancel the assessments relating to overcollections and recurring purchases,

plus penalty, mentioned in the Administrative Law Judge's conclusion of law "D," based upon the identical facts and conclusions of law which compelled conclusion of law "C."

We affirm the determination of the Administrative Law Judge.

Before delving into the substantive issue of the Division's audit methodology, it is necessary for us to address the procedural issue of the propriety of petitioner's "reply brief." The Division claims that petitioner's "brief" is actually in the nature of an exception to the Administrative Law Judge's determination and, as such, has been late filed and should be dismissed. Petitioner counters that its brief merely covers the territory encompassed by the Division's exception and is, therefore, proper. We believe that both parties are correct in part.

Petitioner's brief certainly looks like an exception, with the stated "Purpose" being to "take exception to the areas [of the determination and exception] we believe to be in error" (Petitioner's reply brief, pp. 2-3), and certain of the subheadings listed as "Clarifications to Findings of Facts [sic]," "Exceptions to Conclusions of Law," and "Other Issue not Addressed by Judge Brian L. Friedman." However, the form of the brief notwithstanding, we find that what petitioner has covered in the bulk of its brief, the "Clarifications to Findings of Facts" section, as well as in the "Exceptions to Conclusions of Law" section (subsection "Conclusion 'B,' p. 12") are not, in actuality, exceptions taken, but rather responses to and reflections on the Division's arguments in its exception and brief (see, Petitioner's reply brief, pp. 2-6).

On the other hand, we find that sections "Exceptions to Conclusions of Law" (subsections "Conclusion 'B,'" "Conclusion 'C'" and "Conclusion 'D'"), "Other Issue not Addressed by Judge Brian L. Friedman" and "Summary and Conclusion" cover issues not addressed by the Division in its exception and/or brief. As well, the two issues articulated at the beginning of petitioner's brief go beyond the scope of the Division's exception. Therefore, as petitioner has not filed a timely exception under Tax Law § 2006.7, nor a timely request for an extension to so file, petitioner has not required us to review: the adequacy of the books and records, whether a test period agreement was required, and whether the audit period was properly extended (see, Matter of Armel, Tax Appeals Tribunal, July 23, 1992, distinguishing Matter of Caleri, Tax Appeals

Tribunal, August 11, 1988; Matter of Klein's Bailey Foods, Tax Appeals Tribunal, August 4, 1988). As we see no reason to exercise our discretion under 20 NYCRR 3000.11(e) to review these issues, we will confine our discussion to the points raised by petitioner that respond to the issues raised by the Division in its exception.

Therefore, we begin our analysis by accepting the Administrative Law Judge's conclusion that the Division properly resorted to external indices to estimate petitioner's tax. The Division argues that the reasonableness of this audit methodology is also not in issue because petitioner failed to maintain adequate records to identify taxable sales.

We do not agree with the Division that the failure of petitioner to maintain adequate records precludes an examination into the reasonableness of the audit. We rejected this argument in a similar context in Matter of House of Audio of Lynbrook (Tax Appeals Tribunal, January 2, 1992), noting that:

> "there are a multitude of cases where the taxpayer had inadequate records and the court inquired into the reasonableness of the audit performed [citations omitted]. Further, in some cases the courts not only inquired into the reasonableness of the audit, but also found that the taxpayer had established the audit methodology was unreasonable, without having produced adequate and verifiable source documentation [citations omitted]" (Matter of House of Audio of Lynbrook, supra).

Thus, we conclude that the issue here is whether the Division's audit methodology was reasonably calculated to reflect the taxes due (see, Matter of Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869).

The Division's argument on this point appears to be that the audit methodology, i.e., denying all nontaxable sales, was reasonable because it relied on the presumption of section 1132(c) of the Tax Law that:

> "[a]ll receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt . . . is not taxable hereunder shall be upon the person required to collect tax."

In past cases, we have not accepted section 1132(c) as an automatic justification for an audit methodology and have held instead that the audit methodology must be evaluated under

all of the circumstances existing at the time of the audit (see, Matter of Auriemma, Tax Appeals Tribunal, September 17, 1992; Matter of House of Audio of Lynbrook, supra; Matter of Reference Lib. Guild, supra). In Auriemma, we explicitly stated:

> "while we agree with the Division that there is a statutory presumption pursuant to Tax Law § 1132(c) that certain types of sales are taxable [footnote and citations omitted], we reject the insinuation that this presumption satisfies the Division's burden to devise a reasonable methodology for calculating taxable sales" (Matter of Auriemma, supra).

We believe that these past cases apply the proper rule because they ensure that the Division's duty to select a method of audit reasonably calculated to reflect the taxes due (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451) is a meaningful duty. Therefore, we conclude that the instant audit cannot be automatically sustained under the presumption of taxability, but can only be sustained if, under the facts and circumstances existing at the time of the audit, reliance on the presumption was reasonably calculated to reflect the taxes due.

The facts here are that petitioner made nontaxable, over-the-counter sales and, at the time of this audit, the auditor had reason to know this. However, the auditor persisted in basing this portion of the audit on the presumption that all of the over-the-counter sales were taxable. We think it clear that this audit design, applying the presumption to an entire category of sales, where the auditor knew that the presumption did not apply to that entire category, was not reasonably calculated to reflect the taxes due (see, Matter of Auriemma, supra). In fact, this design resulted in an assessment that the auditor knew was incorrect.

The Division misses the point in its argument that the auditor's knowledge of the nontaxable sales is irrelevant since the taxpayer had the burden of proving nontaxable sales. The taxpayer's burden, where the Division has properly resorted to an audit based on external indices, is to establish that the audit methodology was unreasonable or the amount assessed erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, supra). Where the taxpayer establishes that the audit methodology is based on an assumption that is fundamentally flawed, the taxpayer has sustained his burden of proof and is not required to show the exact

amount of taxes due (see, Matter of Mobley v. Tax Appeals Tribunal, 177 AD2d 797, 576 NYS2d 412, appeal dismissed 79 NY2d 978, 583 NYS2d 195; Matter of Snyder v. State Tax Commn., 114 AD2d 567, 494 NYS2d 183; Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91).

We also believe that the Division's reliance on Matter of On the Rox Liqs., Ltd. v. State Tax Commn. (supra), Matter of House of Audio of Lynbrook (supra), Matter of Dacs Trucking Corp. (supra) and Matter of Reference Lib. Guild (supra) is misplaced. On the Rox Liqs. involved sales made to allegedly exempt organizations. Section 1132(c) of the Tax Law specifically provides that where a vendor fails to obtain, when required, a properly completed exempt organization certificate, or certain other required certificates, "the sale shall be deemed a taxable sale at retail." Because of this specific statutory language, we believe, as we noted in Auriemma, that the reasonableness of the Division's audit methodology may be subject to a different type of analysis when the disallowed sales are those for which a specific certificate is required, and that On the Rox Liqs. discusses this type of audit (Matter of Auriemma, supra; but see, 20 NYCRR 532.4[b][4][v]).

The facts in Matter of Dacs Trucking Corp. (supra) are also fundamentally different than those of the present case. In Dacs Trucking, the Division did not disallow all claimed nontaxable sales, but instead estimated the taxpayer's nontaxable sales at approximately 50% of those claimed by petitioner, based on the evidence produced by petitioner for the test period. Thus, the audit in Dacs Trucking was not based on an assumption contrary to the information known at the time of the audit, nor was it based on an unknown rationale (cf., Matter of Auriemma, supra [where the Division could not describe the source of the taxable percentage it applied to a portion of the petitioner's sales]).

With respect to Reference Lib. Guild, we agree with the Administrative Law Judge that it is distinguishable from the instant case because in Reference Lib. Guild we could not discern what alternatives the Division had in determining the nontaxable sales, since the petitioner there had no sales records for any period and the business had ceased operating. Here, petitioner had

sales records and it is not obvious that these records could not have formed a basis to estimate some rate of nontaxable, over-the-counter sales, even if the records were inadequate to support a detailed audit. Moreover, we find totally unpersuasive the auditor's explanation that he could not conduct an observation test because the business had been sold. We have reviewed several cases where the Division applied the results of an observation test of one business to a different business; thus, this audit technique does not appear unusual (see, Matter of Negat, Inc., Tax Appeals Tribunal, April 9, 1992; Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991). Further, we have rejected this audit technique only when the Division could not describe the basis for its conclusion that the observed business was similar to the petitioner's business (Matter of Negat, Inc., supra; Matter of Basileo, supra; Matter of Fokos Lounge, supra). The Division should not have encountered such a problem here since the instant record indicates that the business before and after the sale was substantially the same.

Finally, we do not agree with the Division that our decision in Matter of House of Audio of Lynbrook (supra) indicates that the audit methodology here was reasonable. The portion of the audit sustained in House of Audio involved claimed nontaxable sales where, as in On the Rox Liqs., certificates were required by statute. Further, in House of Audio it appeared that the information that the taxpayer asserted should have been used by the auditor to estimate nontaxable sales had not been made available to the auditor at the time of the audit. In contrast, here we are not persuaded that the auditor did not have access to the means to estimate the nontaxable sales at the time of the audit.

For all of the above reasons, we conclude that the Administrative Law Judge's determination to cancel the portion of the assessment on nontaxable sales should be sustained.

In light of this ruling, we also affirm the Administrative Law Judge's cancellation of the omnibus penalty under Tax Law § 1145(a)(1)(vi), since "it cannot now be shown that petitioner omitted an amount greater than 25% of the amount of tax required to be shown on the tax return" (Determination, p. 16).

Accordingly, it is ORDERED, ADJUDGED and DECREE that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Bernstein-on-Essex St., Inc., Solomon Bernstein, Officer of Bernstein-on-Essex St., Inc. and Ruth Bernstein, Officer of Bernstein-on-Essex St., Inc. are granted to the extent indicated in conclusions of law "C" and "D" of the Administrative Law Judge's determination, but are otherwise denied; and

4. The notices of determination and demand dated March 25, 1988 assessing omnibus penalty against petitioners Bernstein-on-Essex St., Inc., Solomon Bernstein, Officer of Bernstein-on-Essex St., Inc. and Ruth Bernstein, Officer of Bernstein-on-Essex St., Inc. are cancelled in accordance with paragraph "3" above, and the remaining notices of determination and demand issued to petitioners are modified in accordance with paragraph "3" above, but are otherwise sustained.

DATED: Troy, New York
December 3, 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