STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **THE HUMPHREY HOUSE, 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, 1987 through November 30, 1990.	DECISION DTA NOS. 813375 AND 813376
In the Matter of the Petition of **WILLIAM A. GLEASON, OFFICER OF THE HUMPHREY HOUSE, 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, 1987 through November 30, 1990.	

The Division of Taxation and petitioners The Humphrey House, Inc., 1783 Penfield Road, Penfield, New York 14526, and William A. Gleason, Officer of The Humphrey House, Inc., 833 Whalen Road, Penfield, New York 14526, each filed an exception to the determination of the Administrative Law Judge issued on August 1, 1996. Petitioners appeared by Louis V. Asandrov, Esq. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

Petitioners filed a brief on exception, a brief in opposition to the Division of Taxation's exception and a reply brief. The Division of Taxation filed a brief on exception and a brief in opposition to petitioners' exception. Petitioners' request for oral argument was denied.

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

ISSUES

I. Whether the Division of Taxation properly determined additional taxes due from petitioners for the audit period based on external indices, using a methodology reasonably calculated to project the amount of taxes due.

II. Whether the Administrative Law Judge properly made adjustments to the allowance for employee meals and steward sales.

III. Whether reasonable cause exists for the abatement of penalty.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "10" and "18" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, The Humphrey House, Inc., is a family-styled restaurant that serves lunch and dinner. The restaurant also has a bar where the owner provides free buffet-style food on Sunday afternoons and during certain sporting events that are televised.

The stock in the restaurant was owned equally by Jonathan Ludwig and William Gleason until January of 1990, at which time Mr. Gleason sold his 50 shares of common stock to Mr. Ludwig for $25,000.00. Fifteen thousand dollars of the total sale price was allocated to Mr. Gleason's agreement to a covenant not to compete for three years.

The Division of Taxation ("Division") commenced an audit of the restaurant in July of 1990. Initially, the audit was assigned to Thomas Heagerty who sent an appointment letter, dated October 10, 1990, to The Humphrey House requesting an appointment to see the books and records of the restaurant including all journals, ledgers, sales invoices, purchase invoices, and cash register tapes for the period September 1, 1987 through August 31, 1990. Petitioner[1] provided the auditor with sales tax returns, related worksheets for the sales tax returns, Federal

[1]References to petitioner are to the restaurant, The Humphrey House, Inc., unless otherwise indicated.

and State income tax returns and related worksheets, a sales journal, and a purchase journal for the audit period. However, petitioner did not provide guest checks or cash register receipts. Mr. Ludwig informed the auditor that guest checks and cash register receipts were kept for a month or two and then discarded. Petitioner's accountant, Daniel Tessoni, testified that the accounting system he put into effect at the restaurant required petitioner to record on daily sheets the food, beer and liquor sales, sales tax, and cash paid out for miscellaneous payments from the cash drawer, and to reconcile those amounts with the daily deposits. Those daily sheets were made available to the auditors during the course of the audit.

Because the guest checks and cash register receipts were not available to the auditor, the Division decided to estimate the sales tax due by performing a mark up of purchase invoices. For that purpose, the Division asked petitioner to keep all guest checks and cash register receipts for January 1991. Two other Division auditors assigned to this audit, Andrew Kucharski and Scott Callahan, collected information from the business and summarized the guest checks for the month of January of 1991 to determine how many lunches versus dinners were sold to arrive at an average price for certain food items. The auditors averaged the prices for a particular food item because the price differed depending on whether the item was sold for lunch or dinner.

Initially, the Division calculated the markup on food to be 241%. According to an entry on the audit report on July 26, 1991, this markup was based on discussions Mr. Kucharski and Mr. Heagerty had with the "owner, cook, [and] CPA" concerning food portions. The Division compared this percentage markup with the 273% markup contained in a publication of the National Restaurant Association (Restaurant Industry Operations Report, 1988) concerning the industry average for a medium restaurant.

At some point in the course of the audit, Mr. Heagerty was reassigned within the audit unit and Donald Dahlgren was assigned as the supervising auditor. After numerous discussions with Mr. Ludwig and his accountant, the first of which took place in January of 1992, and after petitioner provided additional documentation, the Division made some allowances for portion

sizes, shrinkage, spoilage, theft and free hors d'oeuvres. The Division did not accept petitioner's request for allowances with respect to employee meals and steward sales.[2] Petitioner also disagreed with the Division's portion size with respect to chicken as well as shrinkage and portions with respect to other food items.

Mr. Dahlgren prepared a worksheet based on his analysis of the information provided by the other auditors. The worksheet listed the purchase invoices for January of 1991 of certain main food items such as Alaskan King Crab, haddock, clams, scallops, shrimp, sole, lobster tails, prime rib, veal, chicken, halibut, swordfish, steak, hamburger, lamb chops, pork chops, duck, ham, corned beef, pastrami, turkey and tuna. The worksheet also contained the cost and quantity of these food items according to the purchase invoices, an allowance for waste depending on the food item, the number of servings and average menu price. Using this information, Mr. Dahlgren calculated the marked-up price for each of those food items by multiplying the number of portions by the average menu price. He totaled these amounts and divided them by the total purchase prices for those particular food items, and other miscellaneous food items such as fruits, vegetables and cheeses contained in the purchase invoices, to arrive at a markup of 193.18%. At hearing, Mr. Dahlgren testified that petitioner's records reflected a markup of 160%. It was unclear what records he was referring to or on what basis the 160% was computed.

The Division had Mr. Ludwig fill out a bar tax sheet and bar questionnaire listing the prices and ounces of the beer and liquor served. Applying that information to the actual purchases of beer and liquor for the quarter ending August 1990, the Division computed a 317% markup on beer and a 332% markup on liquor. Because the Division calculated the audited beer and liquor sales to be $87,579.00 and the sales reported for the test quarter were $87,212.00, it decided to accept the beer and liquor sales as reported by petitioner for the audit period.

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[2]Petitioner claims that it made steward sales, that is, sales at cost of unprepared food to various organizations, customers and relatives of Mr. Ludwig.

The Division applied the 193.18% markup to petitioner's food purchases from May 1, 1986 through April 30, 1989, less purchases of non-food items that had been mistakenly posted to food, and less allowances for theft and free hors d'oeuvres, to estimate food sales. Mr. Dahlgren then added the reported beverage sales for the same three-year period and subtracted the total reported food and beverage sales to calculate additional sales. These additional sales were then divided by the total reported sales for the same three-year period to compute the error percentage of gross sales at 0.117058. The error percentage was then applied to the gross sales reported for the audit period from December 1, 1987 through November 30, 1990, resulting in additional sales tax due of $22,007.65. Mr. Dahlgren explained in his testimony that he used beverage sales in that calculation, even though he accepted petitioner's beverage sales as reported, because he was using petitioner's sales tax returns, which did not break down the beverage and food sales, for the reported sales. He also noted that he used the food purchases for the three-year period in calculating the error percentage, even though eleven months of that three-year period fell outside the audit period, because that information was available to him at that time and he did not want to delay the audit any further. Mr. Dahlgren also stated that he felt that the larger period of time used in his calculations was more representative. During cross examination, Mr. Dahlgren testified as follows:

> "Q. . . . to compute the error rate on these schedules -- that didn't fully go through the audit period, you only had a portion of the audit period?
>
> "A. Again, the periods I had information for were 5/1/86 through 4/30/89. The audit period went to November of 1990, but the last quarter dropped off.
>
> "Q. Why was that information missing, because that is what Mr. Heagerty filed?
>
> "A. Mr. Heagerty filed only information from 4/30/87, 4/30/88 and 4/30/89.
>
> "Q. Was there any indication the period subsequent to 4/30/89 was missing?
>
> "A. No, it wasn't missing. No, he just didn't write down the numbers.

"Q. Why didn't he?

"A. I don't know. I would have rather used that information in fact. Once we got that information, the audit findings, BCMS came within a hundred dollars of what I did.

"Q. Well, you would have rather used that information?

"A. Yes. That was never an issue in any of the conversations we had. I told both of those gentlemen if there is something flawed in any way that I did, show me." (Tr., pp. 81-82.)

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

> On January 19, 1993, Mr. Dahlgren met with petitioner's representatives, David Veniskey and Ellen Williams, both of whom are certified public accountants, to discuss a settlement option. Mr. Dahlgren requested petitioner to submit a letter to waive the penalties and proposed the possibility of waiving the penalties and changing the chicken portions from one piece to one-and-a-half pieces in calculating the percentage markup. These proposed adjustments would have reduced the overall tax due from $40,206.53 to $15,829.00. Petitioner did not agree to this proposal. Using its own portion sizes and the Division's methodology in calculating the percentage markup, petitioner recalculated the food markup to be 168.63% (see, exhibit "5"). During the course of these discussions, petitioner asserted that steward sales in the amount of $400.00 per month or $14,400.00 for the 36-month period should be subtracted from the purchases. Petitioner also claimed that employee meals cost petitioner between 10 to 12 dollars a day or roughly $325.00 per month or $11,700.00 for the 36-month audit period.
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> Both the steward sales of $14,400.00 and the employee meals allowance of $11,700.00 calculated for the 36-month audit period were reflected in petitioner's recalculated markup in its exhibit "5," authored by Mr. Veniskey, and were based on discussions with Mr. Jonathan Ludwig.[3]

The Division issued to The Humphrey House a Notice of Determination, dated March 1, 1993, and to William Gleason a Notice of Determination, dated March 1, 1993, for sales tax due for the period December 1, 1987 through November 30, 1990 in the amount of $22,007.64, plus interest in the amount of $11,940.77 and a $6,602.30 penalty, for the total amount of $40,550.71.

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[3]We modified finding of fact "10" of the Administrative Law Judge's determination to more accurately reflect the record.

Petitioners requested a conciliation conference from the Bureau of Conciliation and Mediation Services ("BCMS"). After a conference was held on December 8, 1993, the conferee requested, in a letter dated February 1, 1994, that petitioner provide him with a breakdown between beverage sales and food sales by quarter for the audit period and food purchases by quarter for the entire audit period. The conferee indicated that this request was a follow up on his inquiry at the conference as to why the Division included beverage sales in its application of the error rate when it determined that no additional tax was due with respect to beverage sales. By letter dated April 29, 1994, the conferee stated that because petitioner did not submit additional documentation to support its claimed allowances for shrinkage, steward sales, Christmas gifts and employee meals, there was no basis to grant further allowances other than in the area of free hors d'oeuvres. According to the conferee, because the Division accepted petitioner's original adjustment for hors d'oeuvres, the conferee was accepting petitioner's subsequent increase in that adjustment to $7,800.00 per year, thereby increasing the adjustment to $23,400.00 for the entire 3-year period. Therefore, based on that adjustment the conferee proposed reducing the tax from $22,007.64 to $19,943.77, plus penalty and interest, conditioned on petitioner's consent to that amount.

By letter dated August 3, 1994, the conferee proposed a further reduction of the tax. Based on information provided by petitioner - namely, the breakdown of food and beverage sales and purchases for the entire audit period - the tax was recomputed based on this additional information in response to petitioner's objections that the Division included the beverage sales in applying the error rate and used purchase and sales figures outside the audit period. However, the conferee noted that a recomputation of the error rate, excluding beverage sales or excluding food sales outside the audit period and using only food sales for the actual audit period, resulted in a higher error rate. Similarly, the conferee noted that a recomputation applying the markup percentage to the food purchases from the audit period and comparing it with the reported food sales from the actual audit period resulted in additional tax due of $55.93. The conferee therefore concluded that a comparison of the purchase and sales figures

for the actual audit period with those figures utilized by the Division, which included figures outside the audit period, "indicated no detrimental affect on the tax liability". He further opined that the audit method used by the Division had a rational basis and that it reasonably calculated the tax liability "given the information available at hand". The conferee cancelled the sales tax for the last quarter ending November 30, 1990, however, because there was no evidence that the Division requested petitioner's books and records for that period. The conferee found no basis for any further allowances for Christmas gifts, employee meals, steward sales, shrinkage or hors d'oeuvres because petitioner had not submitted any documentation to substantiate its claims. However, the conferee proposed, for the purpose of resolving the dispute, that the Division's 193.18% markup be averaged with petitioner's 168.63% markup resulting in a revised tax due of $12,504.10. Therefore, subject to petitioner's signing of a consent agreement, the conferee offered a reduction of the tax to $12,504.10, plus cancellation of the penalty and a reduction of interest to the minimum statutory interest. Petitioner did not consent to this proposed reduction.

The BCMS conferee issued to The Humphrey House a conciliation order, dated September 2, 1994, recomputing the statutory notice by cancelling only the sales tax for the last quarter ending November 30, 1990. The tax due was $20,090.65. Next to the entries for penalty and interest are the words "computed at applicable rate." The conferee also issued to William A. Gleason a conciliation order, dated September 2, 1994, recomputing the statutory notice by cancelling the tax for the period after December 31, 1989 inasmuch as the sales agreement indicated that Mr. Gleason sold his interest in the business in January of 1990. The tax due was $15,204.15 with penalty and interest computed at the applicable rate.

Petitioners each filed a petition dated December 1, 1994. In their petition, petitioners argued that adequate records were available to perform an audit, and therefore, the Division should not have used a markup of purchases to estimate the tax due; that the method used to estimate the sales tax liability was arbitrary and capricious because the auditor used records outside the audit period and included beverage sales in applying the error rate when no additional tax was due for the bar sales; and that because the initial audit was fundamentally

devoid of rationality, it was not necessary for the taxpayer to prove the exact amount of the over assessment. Petitioner, William Gleason, did not challenge the Division's determination that he was a person responsible for the collection of sales tax.

The Division filed two answers, dated March 8, 1995, to each petition affirmatively stating, inter alia, that the use of a markup audit was proper because petitioner did not maintain any source records for the period at issue, and that the use of sales figures outside the audit period to determine a markup percentage was not irrational.

At the hearing held on October 10, 1995, the Division submitted into evidence work papers recomputing petitioner's sales tax based on the breakdown of food and beverage sales for the audit period and the food purchases by quarter for the audit period that petitioner had provided to the BCMS conferee. In those work papers, the auditor made allowances for non-food items and theft of food purchases, as requested by petitioner, and hors d'oeuvres, in the respective amounts of $33,851.68, $9,700.49 and $9,100.00.[4]

The Division calculated the taxable food sales per quarter and set forth these calculations in its Exhibit "O". The taxable food sales for the last quarter and for the entire audit period were calculated as follows:

Audit Period	Purchases per books	Adjustments to purchases	Purchases after adjustments	Markup per audit	Taxable Food sales per audit
9/1/90-11/30/90	$ 83,596.04	$ 4,384.97	$ 79,211.07	$193.18	$ 153,019.95
12/87-11/90	1,003,900.55	52,652.17	951,248.38	193.18	1,837,621.62

The Division then subtracted the reported sales per petitioner's books to calculate the sales tax due for the last quarter of the audit period and the entire audit period as follows:

Additional Additional

[4]During discussions with petitioner's representatives, petitioner claimed that the cost for free hors d'oeuvres amounted to $9,100.00 for the three-year period. Petitioner then claimed that his invoices showed that the cost for the free hors d'oeuvres amounted to $10,500.00 for the three-year period. Petitioner presented no substantiation to support this claim or the claim, referred to in the BCMS conferee's proposed settlement of April 29, 1994, that free hors d'oeuvres amounted to $7,800.00 per year.

Audit Period	Taxable Food Sales per audit	Taxable Food Sales per books	Taxable Food Sales per audit	Tax Rate	Tax due per audit
9/1/90-11/30/90	$ 153,019.95	$ 135,847.30	$ 17,172.65	0.07	$ 1,202.09
12/87-11/90	1,837,621.62	1,529,190.50	308,431.12	0.07	21,590.18

We modify finding of fact "18" of the Administrative Law Judge's determination to read as follows:

> At hearing, Mr. Ludwig testified that employee meals were provided at the average cost of three dollars a day per employee. He also stated that he employed approximately 30 employees and he gave Christmas gifts, such as boxes of shrimp, strip loin or prime rib, to his employees amounting to approximately $2,000.00 every year. He further testified that he sold food items at cost to certain family members and customers that "probably" averaged $500.00 or $600.00 a month. In fact, Mr. Ludwig testified credibly under oath in response to the Administrative Law Judge's questioning as follows:
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> > ADMINISTRATIVE LAW JUDGE: "How do you know it is $500 or $600?"
> >
> > MR. LUDWIG: "I am just guesting [sic]" (tr., p. 182).
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> When questioned about how long he would keep his food inventory, Mr. Ludwig testified as follows:
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> > ALJ: "In terms of your inventory, Mr. Tessoni mentions sometimes the inventory would stay longer than usual because you would get a sale on some items and get more and put it in the freezer."
> >
> > Mr. Ludwig: "Right. That specific month I bought twenty cases of king crab legs that cost me $4,000.00, because it was cheap and it only lasted me three months."
> >
> > ALJ: "That would last you three months?"
> >
> > Mr. Ludwig: "Right."
> >
> > ALJ: "How much did you use that January?"
> >
> > Mr. Ludwig: "Not very much because I wasn't very busy in January." (Tr., p. 183.)[5]

During the course of the hearing, petitioner was granted the opportunity to submit post-

[5]We modified finding of fact "18" of the Administrative Law Judge's determination to include further testimony of Mr. Ludwig.

hearing affidavits in support of its claims concerning adjustments to food purchases for free hors d'oeuvres, employee meals and steward sales.

At the close of the hearing, the Administrative Law Judge stated that no further documents would be accepted after the close of the hearing on October 10, 1995, with the exception of the affidavits to be submitted in support of petitioner's claims with respect to free hors d'oeuvres, employee meals and steward sales.

Petitioner submitted fifteen post-hearing affidavits, thirteen of which were from individuals and two of which were submitted on behalf of Camp Haccamo and the Penfield Fire Department, stating that the affiants purchased a certain amount of unprepared food at cost from Mr. Ludwig on an annual basis. The amount of these steward sales claimed on an annual basis totaled $14,686.50. With the exception of the affidavit of Kenneth R. Fisher, none of these affidavits specified a time period for these annual food sales at cost. Kenneth Fisher stated in his affidavit that based on a review of his records, he purchased $526.50 worth of food at cost from Mr. Ludwig in 1989 and continued to purchase approximately this amount on a yearly basis since 1989.

Petitioner submitted 103 post-hearing affidavits from customers stating that petitioner provided free buffet-style food on Sunday afternoons and on several occasions throughout the year. Again, these affidavits do not specify a time period for the free buffet-styled events or indicate the quantity of food provided.

Petitioner also submitted 13 post-hearing affidavits of employees stating that petitioner supplies employees with meals at each shift if the shift totaled 3 hours or more. With the exception of three affiants, all the employees commenced employment with petitioner prior to, or during, the audit period.

Along with the above post-hearing affidavits submitted on November 10, 1995, petitioner also submitted a post-hearing affidavit of Mr. Ludwig and a post-hearing affidavit of Ellen Williams, a certified public accountant who worked with Mr. Ludwig in preparing workpapers concerning requested adjustments from the Division.

OPINION

The Administrative Law Judge determined that petitioner's failure to maintain source documentation warranted the Division's use of a test period audit using external indices such as purchases to determine markup percentages (Matter of Skiadas v. State Tax Commn., 95 AD2d 971, 464 NYS2d 304). Of course, the Division must select an audit method which is reasonably calculated to reflect the tax due (Matter of Urban Liqs. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138), but exactness in the outcome of the audit is not required (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454). The Administrative Law Judge determined that the record contained sufficient evidence to establish a rational basis for the audit (Matter of Grecian Sq. v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219), placing the burden on petitioner 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).

On appeal, petitioner argues that the methodology chosen was not reasonably calculated to reflect the tax due. Petitioner believes that the inclusion of beverage sales, accepted as reported by the Division, in the calculation of the error rate and the markup of purchases was devoid of reason, relying on Matter of Club Marakesh v. Tax Commn. of State of New York (151 AD2d 908, 542 NYS2d 881, lv denied 74 NY2d 616, 550 NYS2d 276). Although petitioner wishes to distinguish itself from Club Marakesh, there is essentially no difference in the underlying facts. In both cases, the taxpayers could not produce source documentation for the audit period, forcing the Division to utilize an indirect methodology. Even though the court in Club Marakesh found merit in the contention that use of a prior year's figures could have distorted the calculation of the margin of error, the use of such figures was not a fatal flaw in the Division's audit since production of the source documents would have obviated use of such figures. Likewise, in the instant matter, petitioner's failure to produce source documentation was the reason for resorting to information both within and without the audit period to ascertain the margin of error. Although the information for the audit period was produced at the BCMS

conference (which, upon further testing, confirmed the accuracy of the other periods used), it did not merit finding that the audit lacked a rational basis.

In a related argument, petitioner contends that the Division should not have included the beverage sales when it calculated the additional taxes due. However, the Division explained, and the Administrative Law Judge agreed, that it did not prejudice petitioner because the beverage sales were accepted as reported and were only utilized in the calculation of additional taxable sales when compared to the total sales reported on the tax returns, which reflected both food and beverage sales. Hence, the beverage sales were added back to the audited food sales and then subtracted from the total food and beverage sales reported on the sales tax returns, netting the beverage sales and yielding the additional sales found per the audit. This figure was used to determine the margin of error percentage by dividing it by total sales per books which was then applied to the reported sales. Inclusion of the beverage sales was absolutely necessary for avoiding distortion and making a more accurate projection of additional taxable sales. Petitioner is mistaken in its belief that the inclusion of the beverage sales distorted its audited tax liability, a conclusion born out by the additional computations ordered by the conferee.

Petitioner also challenged the Division's calculation of the markup percentage on the basis that it was developed from information outside of the audit period and did not reflect the amount of sales from guest checks and register receipts for the month of January 1991. However, the record was clear and the Administrative Law Judge noted that the calculation of the markup was much more than the simple division of sales per the guest checks by the purchases for the same month. The auditor did a painstaking analysis of items purchased, cost, quantity, allowances for shrinkage, spoilage, theft and portions, number of servings yielded by the amounts purchased and average sales prices, all of which produced a total sales per markup for the month of January 1991. In addition, the taxpayer and his representatives were consulted for input concerning the markup determined by the auditor and compromises were reached on such allowance items as spoilage, theft, shrinkage, hors d'oeuvres and portions. The auditor's original markup percentage was reduced from its initial 241% to 193.18%, well within the

industry average for like restaurants, as set forth by the National Restaurant Association (Restaurant Industry Operations Report, 1988). Although such reports have been accepted as the sole basis for audit results (see, Shukry v. Tax Appeals Tribunal, 184 AD2d 874, 585 NYS2d 531 [where use of Dun and Bradstreet survey to compute tax due was found to have a rational basis]), the report was only used as an independent and general measure of the instant audit results. Based upon figures in that report for food sales per seat and cost of sales for restaurants in the median quartile, the markup was projected to be 273%.

Although petitioner makes much of the Division's audit guidelines for markup tests, specifically those dictating use of selling prices and cost prices from within the test period, it is mistaken in its inference that the guest checks and register tapes accurately reflected this information. The test employed by the Division was reasonably calculated to determine the taxes due and the markup percentage had a rational basis.

As stated by the Administrative Law Judge:

> "the Division may use information outside the audit period, or any other external indices, as long as there is a rational basis for its use. Inasmuch as petitioner's failure to maintain adequate records prevented exactness in the calculation of the tax due, exactness in determining the the sales tax liability is not required (Matter of Meyer v. State Tax Commission, 61 AD2d 223, 402 NYS2d 74, 78, lv denied 44 NY2d 645, 406 NYS2d 1025). A determination as to whether the Division utilized a reasonable audit methodology must be based upon what was presented to the auditor during the time of the actual audit (Matter of Northern States Contracting Co., Inc., Tax Appeals Tribunal, February 6, 1992)" (Determination, conclusion of law "E").

Without the source documentation, the Division utilized the purchase records on hand, some of which were outside the audit period. Although it also had access to records within the audit period, it was not bound to utilize them and their use of records outside the audit period was not prejudicial to petitioner.

Similarly, in the error rate calculation, the use of food and beverage sales from outside the audit period provided a larger representative period and, as noted by the Administrative Law Judge, resulted in a lower error rate than if only figures from within the audit period were used.

Petitioner contends that the Administrative Law Judge erred in allowing exhibit "O" into evidence. At the request of the conferee, the auditor prepared a schedule of food sales per the audit and calculated the tax due thereon. The schedule was admitted in evidence by the Administrative Law Judge as exhibit "O." Petitioner specifically raised no objections to the introduction of the exhibit, noting "[w]e have no objections to this document as long as we can call Mr. Veniskey to discuss it" (tr., p. 185). Petitioner's accusation that Mr. Dahlgren lied about the existence of exhibit "O," an allegation which the Administrative Law Judge specifically did not find in her determination, and its contention that exhibit "O" should have been excluded from evidence pursuant to EC 7-26 are without merit. The credibility finding by the Administrative Law Judge was rational and within her authority and we will not disturb said finding (Matter of Spallina, Tax Appeals Tribunal, February 27, 1992). The Code of Professional Responsibility EC 7-26 prohibits the use of fraudulent, false, or perjured testimony or evidence when the lawyer proffering said evidence knows that it is false, fraudulent or perjured. Whether petitioner is directing its objection at the Division's counsel or the Administrative Law Judge is not discernible, but either is unpersuasive. By failing to raise an objection to the admission of the document at hearing or mention this issue in its exception, petitioner has not preserved its right to challenge the admission on appeal (see, Matter of Klein's Bailey Foods, Tax Appeals Tribunal, August 4, 1988).

With regard to the issue of penalty, the Administrative Law Judge sustained the imposition of penalty and found that petitioner did not show that its failure to pay the tax in a timely manner was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][1][iii]; 20 NYCRR 536.5). The Administrative Law Judge essentially found that petitioner did not meet its burden of showing that penalty was improperly assessed. On appeal, petitioner argues that Mr. Ludwig was an unsophisticated taxpayer who relied on the advice of his tax professionals in throwing out all his source documentation and instituting an accounting system which ultimately led to the indirect audit methodology utilized herein.

Petitioner has still not met its burden of proof regarding reasonable cause. There was no

evidence introduced to prove that Mr. Ludwig was an unsophisticated taxpayer and he did not testify as to his reliance on his tax professionals. It is well established that reliance on a tax advisor does not necessarily constitute reasonable cause for the remission of penalties (see, Matter of Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557; Matter of LT & B Realty v. State Tax Commn., 141 AD2d 185, 535 NYS2d 121). In order to establish reasonable cause, the reliance itself must be reasonable (Matter of BAP Appliance Corp., Tax Appeals Tribunal, June 29, 1989). In evaluating whether the reliance was reasonable, the taxpayer is required to show that he acted with ordinary business care and prudence in attempting to ascertain his tax liability (Matter of A & V Crown, Tax Appeals Tribunal, May 24, 1990). Petitioner must also demonstrate that the advice came from a competent tax advisor (Matter of A & V Crown, supra). The instant record is devoid of any evidence that would establish that it was reasonable for Mr. Ludwig to have relied on his tax professionals and, thus, the imposition of penalty is sustained.

The Division has taken an exception to the Administrative Law Judge's conclusions regarding the allowance for employee meals and steward sales. The Administrative Law Judge accepted the credible testimony of Mr. Ludwig, affidavits of employees, and petitioner's workpapers in coming to her conclusion that an allowance should be made for employee meals in the amount of $11,880.00. The Administrative Law Judge reasoned that the meals were taxable pursuant to 20 NYCRR 527.8(j)(1), but the value was petitioner's cost. As such, the value of the meals was added to taxable sales but subtracted from the food purchase cost for markup purposes.

The Division argues that the value of the meals must be market value as indicated by the regulations at 20 NYCRR 526.7(d). We disagree. If we view this as a barter transaction, as the Division urges, the employer is purchasing, for the cost of the food, the convenience of having his employees remain on premises, readily available to return to work, in addition to the good will engendered. Further, the regulation at 20 NYCRR 527.8(j)(3) states that where employee meals are exempt from tax (not the case herein) as specified in 20 NYCRR 527.8(j)(1), the

employer remains liable for tax on the cost of the food furnished to the employees, not the assigned value of said food. Thus, there is a rational basis for the logic applied by the Administrative Law Judge in using the cost of the food as the value of the meal. Further, in the past, the Division has made allowances for employee meals where the taxpayer had no documents substantiating the number of meals served, number of employees served or the cost of the meals, and has accepted meal values between $2.37 and $3.61 (Matter of Carmine Rest. v. State Tax Commn., 99 AD2d 581, 471 NYS2d 402).

The Division also excepted to the Administrative Law Judge's allowance for steward sales. The Administrative Law Judge found Mr. Ludwig's testimony that he sold at cost unprepared food to customers in the sum of $500.00 to $600.00 per month credible. She did not accept the affidavits from customers of steward sales for the purpose of amounts, but did accept them as confirmation of said sales. At $600.00 per month for 33 months steward sales totaled $19,800.00, warranting a reduction in tax of $2,677.47.

The Division argues that the evidence in support of the reduction was not clear and convincing. Citing petitioner's burden of proof on the issue, the Division noted that the evidence in the record varied widely on the alleged amounts of steward sales and Mr. Ludwig testified credibly under oath in response to the Administrative Law Judge's questioning as follows:

> ADMINISTRATIVE LAW JUDGE: "How do you know it is $500 or $600?"
>
> MR. LUDWIG: "I am just guesting [sic]" (tr., p. 182).

We do not believe petitioner has demonstrated by clear and convincing evidence that it is entitled to an allowance for steward sales. There are no records of such sales and even Mr. Ludwig could not say with certainty in what amounts they were made, especially during the audit period. The fact that petitioner has estimated one amount in its revised workpapers, another in the affidavits of its customers and still another in the testimony of Mr. Ludwig (if only a guess) does not demonstrate by clear and convincing evidence entitlement to an allowance for steward sales (Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 536 NYS2d

209, lv denied 74 NY2d 603, 542 NYS2d 518).

We have duly considered all the other arguments of petitioners and find them to be without merit.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of The Humphrey House, Inc. and William A. Gleason, Officer of The Humphrey House, Inc. is denied;

2. The exception of the Division of Taxation is granted to the extent that the allowance of steward sales is denied, but is otherwise denied;

3. The determination of the Administrative Law Judge is modified in accordance with paragraph "2" above, but is otherwise affirmed;

4. The petitions of The Humphrey House, Inc. and William A. Gleason, Officer of The Humphrey House, Inc. are denied, except as modified at conference and by the Administrative Law Judge's determination not inconsistent herewith; and

5. The notices of determination, dated March 1, 1993, are sustained as modified.

DATED: Troy, New York
July 31, 1997

/s/Donald C. DeWitt
Donald C. DeWitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.
Joseph W. Pinto, Jr.
Commissioner