

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petitions	:	
of	:	
<b>JUERGEN STAEKELER AND</b>	:	DECISION
<b>EDELWEISS INTERNATIONAL, LTD.</b>	:	DTA NOS. 819435
	:	AND 819436

for Revision of Determinations or for Refund of Sales and  
Use Taxes under Articles 28 and 29 of the Tax Law for the :  
Period September 1, 1997 through May 31, 2000.

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Petitioners Juergen Staekeler, 2873 N. Wading River Road, Wading River, New York 11792 and Edelweiss International, Ltd., c/o Jay Oher, State Tax Consulting, Inc., 1045 Route 109, Suite 100, N. Lindenhurst, New York 11757, filed an exception to the determination of the Administrative Law Judge issued on December 16, 2004. Petitioners appeared by Michael Alexander, Esq. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Lori Antolick, Esq., of counsel).

The Division of Taxation filed a letter brief in lieu of a formal brief in opposition and petitioners filed a letter brief in reply. Oral argument was not requested.

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

***ISSUE***

Whether the audit methodology employed by the Division of Taxation was reasonably calculated to reflect the sales and use taxes due.

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge except for finding of fact “11” which has been modified. The Administrative Law Judge’s findings of fact and the modified finding of fact are set forth below.

Petitioner Edelweiss International Ltd., doing business as Heros Plus (“Heros”), was a delicatessen and sandwich shop located on a busy thoroughfare near a traffic circle in Riverhead, New York. A regional hospital was located diagonally across the street. Petitioner Juergen Staekeler was the sole shareholder of the business. Heros sold prepared food as well as unprepared food such as cold cuts by the pound, potato salad and macaroni salad. It also sold German novelty items. It did not have any inside seating and did not sell beer or cigarettes.

On June 7, 2000, the Division of Taxation (“Division”) sent a letter to Heros requesting an audit appointment. The letter asked that Heros have all of its books and records pertaining to its sales and use tax liability for the period under audit, September 1, 1997 through May 31, 2000, available on the appointment date including “financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, federal income tax returns, and exemption certificates.” The letter further explained that “[e]xemption certificates not made available at this appointment may be disallowed. If an exemption certificate is disallowed, you will be held liable for any tax due on the related transactions.” In response, the Division saw a general ledger, a daybook, copies of Federal returns, purchase invoices, sales tax worksheets, sales tax returns and monthly balance sheets. The Division was not presented with any cash register tapes or any reconciliations between the daily sales and the bank deposits.

The absence of cash register tapes was regarded as a serious problem because without cash register tapes the Division could not verify the accuracy of the amounts recorded in the daybook, the Federal returns or the general ledger. A second problem was presented because of the nature of the business. That is, food sales may be either taxable or nontaxable. For example, prepared food is taxable while unprepared food, such as cold cuts sold by the pound, is not taxable. Here, although certain records were made available, there were no books or records which showed whether Heros' sales were taxable or nontaxable. The Division was also unable to account for cash deposits because of the failure to present cash register tapes or reconciliations between daily sales and bank deposits. On the basis of the forgoing, the Division concluded that the books and records were inadequate to determine taxable sales and that an observation test was necessary.

An observation test was conducted on Thursday, October 24, 2000. A Thursday was selected as the day to conduct the observation test on the basis of the auditor's opinion that Thursday was a representative day for sales. This judgment was premised upon having previously conducted 50 to 100 audits of delicatessens and an examination of the business's daybook of recorded sales for the months of September and October during the audit period. Further, the auditor was informed by petitioners' accountant that the amount of the business's sales did not fluctuate over the course of a year.<sup>1</sup>

One investigative aide conducted the observation test from 7:00 A.M. until noon and a second investigative aide resumed the test until the store closed at 5:00 P.M. During the observation test, the investigative aides listed each item that was sold, how much the item was

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<sup>1</sup> An adjustment for sales fluctuations over the course of a year was referred to as seasonality.

sold for and whether the item was taxable. The investigative aides found that on the day of the observation, Heros had gross receipts of \$2,095.00 and taxable sales of \$1,577.57.

The highest temperature on the day of the observation test was about 60 degrees and it was drizzling intermittently in the morning. The drizzling stopped later in the day.<sup>2</sup>

The investigators noted that six individuals worked at the store. The first employee at the delicatessen began working at 6:30 A.M. Four employees worked until 5:00 P.M. Mrs. Staekeler was at the delicatessen from 9:15 A.M. until 1:00 P.M.

The delicatessen was located adjacent to Le's Nails and both stores were situated between a Getty gasoline station and a shopping center. There were 12 parking spaces for both stores. One employee of the store explained to an investigator that the business slowed down considerably when the nail salon opened because, once the nail salon opened, the delicatessen's customers had difficulty finding a parking spot. The investigators noted that when they changed shifts at noon, there were no empty parking spaces available for customers. They also noted that Heros was busy during the lunch period, but by 3:30 P.M., the amount of business activity had diminished. Mrs. Staekeler pointed out that Heros used to be open later in the day but then started closing earlier.

Heros had two cash registers, one was made by Samsung and one was made by Sharp. At the start of the observation, the investigator zeroed out the cash registers. The investigators noted that the tape on the Sharp register did not work and the Samsung register did not have a

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<sup>2</sup> The investigator who conducted the morning shift of the observation test described the weather as 60 degrees with intermittent drizzle. The afternoon investigator said that it was drizzling slightly but that the drizzle stopped a short while later and that there was no additional precipitation during the observation.

working tape until 11:40 A.M. when an employee replaced the paper. A catering order was not rung up at all and other items were improperly rung up.

In order to calculate the amount of tax due, the Division multiplied the amount of the daily taxable sales, according to the observation, by the 848 days that the business was open during the audit period according to petitioners' daybook, which resulted in audited taxable sales of \$1,337,779.00.

We modify finding of fact "11" of the Administrative Law Judge's determination to read as follows:

The Division also analyzed petitioners' sales of German novelty items. The auditor noted that no German novelty items were sold during the observation test, and when examining the German novelty items, she did not see any sales receipts or a price list. In addition, the auditor was not presented with any resale certificates or any indication that these items were resold to a wholesaler. Mr. Staekeler gave his invoices and resale certificates for the purchase of the German novelty items to his accountant who did not make the invoices and resale certificates accessible to the auditor. The auditor stated that she relied upon a Robert Morris Associates survey of retail gift or souvenir shops that sold the same type of item, and then she applied a markup of 100 percent. The audit papers do not contain a legible copy of the cover page of the survey showing the name of the survey used. The pages copied from the "survey" also do not identify themselves as being from the Robert Morris Associates survey. The amount of purchases was obtained from wire transfers and some purchase invoices.<sup>3</sup>

The Division calculated audited taxable sales by adding the sales determined by the observation test to the estimated sales of the German novelty items. Thereafter, the Division subtracted petitioners' reported taxable sales from the audited taxable sales to determine

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<sup>3</sup>We modified finding of fact "11" to more accurately reflect the record.

additional taxable sales. The amount of the additional taxable sales was divided by the reported taxable sales to calculate an error rate of 1.5551. Lastly, the amount of additional sales tax due was determined by multiplying the sales tax rate by the product of the error rate and the reported taxable sales.

Capital purchases were analyzed in detail. As a result, additional tax of \$1,600.16 was determined to be due on Heros' purchase of equipment.

On the basis of the forgoing audit, the Division issued a Notice of Determination (assessment number L-019696856), dated July 16, 2001, to Edelweiss International Ltd. which assessed sales and use taxes for the period September 1, 1997 through May 31, 2000 in the amount of \$73,342.18 plus interest of \$23,505.18 and penalties in the amount of \$28,413.01 for a balance due of \$125,260.37. The Division also issued a Notice of Determination (assessment number L-019809363) to Juergen Staekeler, dated July 19, 2001, which assessed sales and use taxes for the period June 1, 1998 through May 31, 2000, in the amount of \$54,167.61 plus interest in the amount of \$14,866.52 and penalties in the amount of \$20,743.18 for a balance due of \$89,777.31. In each instance, the penalties were imposed for negligence and underpayment of tax including the omnibus penalty.

According to a statistical analysis of the auditor's transcription of the delicatessen's daybook for September and October, Thursdays were the second busiest day of the week. The analysis of the auditor's transcription shows that sales on Thursdays were approximately 12.6 percent higher than the average of all of the data. It also showed that there was a great deal of variability in the daily amount of sales.

In August 1997, a nail salon opened next door to Heros which had the effect of reducing the parking which was available for Heros' customers. The lack of parking caused sales to diminish. This was one of the reasons why Mr. Staekeler decided to open another store.

In 1999, Mr. and Mrs. Staekeler began operating a new business known as Wildwood Deli. During this period, Mr. Staekeler placed a manager in charge of Heros. Mr. Staekeler believes that the sales of Heros suffered from the absentee management. Eventually, Mr. Staekeler returned to Heros because he wanted to reverse the decline.

It was the practice of Heros' accountant to report a fixed percentage of the delicatessen's total sales as taxable. Heros' sales and use tax returns did not reflect any seasonal fluctuations.

A comparison of Heros' menu, at different times, shows that the prices of the food offered by the delicatessen increased over time. The audit workpapers show that at one juncture, the Division was prepared to include inflation as a factor in computing the amount of tax due based upon the consumer price index of the United States Department of Labor, Bureau of Labor Statistics. For an unknown reason, this was not done.

#### ***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge first observed that the Tax Law imposes a sales tax on the receipts from every retail sale of tangible personal property except as otherwise provided (Tax Law § 1105[a]). The Tax Law provides that if a sales tax return was not filed, or if a return when filed was incorrect or insufficient, the amount of tax due shall be determined by the Division from such information as may be available (Tax Law § 1138[a][1]). If necessary, the tax may be estimated on the basis of external indices, but the Division is required to select a method reasonably calculated to reflect the tax due.

The Administrative Law Judge noted in detail the standard for reviewing a sales tax audit where external indices were used. The Administrative Law Judge stated that when the use of external indices is warranted and the audit method employed is facially sound, the taxpayer must prove by clear and convincing evidence that the audit method employed and the amount of the assessment were erroneous (*see, Matter of Your Own Choice*, Tax Appeals Tribunal, February 20, 2003).

The Administrative Law Judge found that the arguments premised upon petitioners' daybook do not meet this burden. The Administrative Law Judge noted that there was no reason to believe that the data in the daybook was sufficiently accurate to establish that the observation test reached an erroneous result. The Administrative Law Judge observed that the conduct of Heros' employees during the observation test supports this conclusion. During the observation test, the cash register tape on one machine was not working and a tape on the second machine was not inserted until about 11:00 A.M. A catering order was not rung up and other items were improperly rung up. The Administrative Law Judge noted that even if the audit method was less than precise, the imprecision resulted from the inadequacy of petitioners' records, a problem of petitioners' own making. The Administrative Law Judge concluded that petitioners failed to present clear and convincing evidence that the Division's audit method or result were erroneous.

Petitioners contended that the auditor knew that the months of September and October were busier months from an examination of the daybook. The Administrative Law Judge found that the evidence did not support this claim. First, there was no evidence that the auditor examined the other months in the daybook in any detail, and since there was no documentary backup for the daybook there would be no reason to do so. Second, the auditor asked



petitioners' accountant if there were any seasonal fluctuations and she was told there were none. The Administrative Law Judge observed that if there were seasonal fluctuations, this would have been called to the attention of petitioners' accountant because it would have resulted in lower payments of sales tax in certain quarterly periods. Lastly, the Administrative Law Judge pointed out that the sales tax returns, which were purportedly based on a percentage of sales in the daybook, did not reflect any seasonal fluctuations.<sup>4</sup>

The Administrative Law Judge found, based on the record, that the observation test was conducted in October because the audit was started in June and that by the time the Division reviewed the books and records and determined that they were inadequate, it was that time of the year. Further, the Administrative Law Judge found that the auditor chose a Thursday based on her experience that Thursdays were a representative day of the week for this type of business. The Administrative Law Judge pointed out that an auditor's experience is a rational basis for estimating taxable sales.

Petitioners next contended that an adjustment was warranted because the audit does not take into account days where sales were reduced because of inclement weather. The Administrative Law Judge found this argument flawed, because such argument failed to consider the fact that the Division noted that there was inclement weather on the day that the observation test was conducted. Therefore, the Administrative Law Judge found that petitioners had already

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<sup>4</sup>Petitioners argued that the Division has taken an inconsistent position. Petitioners submit that having concluded that the sales and use tax returns were inaccurate, the Division cannot rely on the same sales and use tax returns to show that there was no seasonality. The Administrative Law Judge found this argument a *non sequitur* because it overlooks the fact that petitioners' accountant computed taxable sales on the basis of a percentage of the gross sales figures presented to him. Presumably these are the same amounts in the daybook. It follows that petitioners cannot now claim that the daybook supports the conclusion that there were seasonal fluctuations when the sales tax returns do not.

received the benefit of this adjustment and were not entitled to an additional adjustment for inclement weather.<sup>5</sup>

Petitioners also urged that the assessments should be reduced by 9 percent to reflect the period of time that the delicatessen's sales declined while Mr. Staekeler was pursuing other business ventures. This argument was also premised upon an analysis of the daybook, which the Administrative Law Judge found to be of questionable reliability. The Administrative Law Judge doubted the proposition that both Mr. and Mrs. Staekeler abandoned Heros when the second operation began. The Administrative Law Judge noted that Mrs. Staekeler was at Heros during a substantial portion of the time that the observation test was being conducted.

Petitioners next claimed that the Division erred by failing to make an adjustment for inflation. Petitioners correctly pointed out that a comparison of the menus in the audit workpapers, obtained at different times, shows that the prices of the food offered by the delicatessen increased over time. The Administrative Law Judge directed that the Division adjust its computation of additional sales tax due by an inflation factor based upon the consumer price index of the United States Department of Labor, Bureau of Labor Statistics.

According to Mr. Staekeler, when he first purchased Heros in 1995, the business was open from 7:00 A.M. to 5:00 P.M. on weekdays. Later, he began closing at 4:00 P.M. Mr. Staekeler claimed he was not open until 5:00 P.M. during the audit period, and if the Division saw activity from 4:00 P.M. to 5:00 P.M., it was unusual. Accordingly, petitioners argued that an adjustment is warranted because Heros purportedly normally closed at 4:00 P.M. The Administrative Law Judge found Mr. Staekeler's testimony on this point questionable. The

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<sup>5</sup>Similarly, the Administrative Law Judge noted that if sales were reduced by having less parking available for customers, this factor was also reflected in the observation test which was conducted.

Administrative Law Judge concluded that petitioners failed to establish by clear and convincing evidence that this adjustment is warranted.

Petitioners next submitted that an adjustment is warranted because the Division's calculations do not take into account the fact that the delicatessen closed at 3:00 P.M. on Saturdays. The Administrative Law Judge agreed. The auditor's workpapers clearly show that the delicatessen closed at 3:00 P.M. on Saturdays. Under the circumstances, the Administrative Law Judge directed that taxable sales for one day of the week should be reduced by the amount of the taxable sales observed during the hours of 3:00 P.M. to 5:00 P.M.

Petitioners argued that the Division never reviewed the purchase invoices given to it and as a result did not take into account the resale certificates in petitioners' possession. The Administrative Law Judge rejected this claim, since the weight of the evidence is that the Division was never shown any invoices for German novelty items. Rather, it appeared that these documents were given to petitioners' accountant and for some reason were never given to the auditor. At the hearing, petitioners offered a group of invoices with resale certificates attached thereto. Since no reason has been presented why the resale certificates should not be taken into account, the Administrative Law Judge directed the Division to reduce the portion of the assessment pertaining to the German novelty items by the amounts reflected by the resale certificates and the accompanying invoices.

Petitioners asserted that the use of the Robert Morris Associates Survey for gift or novelty shops to determine the markup for the German novelty items was flawed because petitioners operated a delicatessen. According to petitioners, the markup on German novelty items was at most 50 percent and that most of the German novelty items were sold at wholesale.

Petitioners assert that the price of the novelty items was listed on the bottom of the item. The Administrative Law Judge rejected this argument, noting petitioners never produced any evidence during the audit of selling prices and, as a result, the Division used the only method available to it.

Petitioners also argued that the audit was flawed because the auditor did not make any provision for ending inventory of the German novelty items in the audit methodology. The Administrative Law Judge also rejected this argument as without merit, noting the Division calculated the sales of the German novelty items by multiplying the estimated markup (100 per cent) by petitioners' purchases. Inventory had no bearing on determining the amount of tax due.

Petitioners complained that the Division failed to call the two investigative aides to testify. The Administrative Law Judge found that if petitioners wished to obtain the testimony of the investigative aides, they should have taken steps to secure their presence at the hearing (*see*, 20 NYCRR 3000.6).

### ***ARGUMENTS ON EXCEPTION***

Petitioners, on exception, continue to challenge the accuracy of the audit methodology raising substantially the same arguments as were raised below. Petitioners argue that the observation day used was not representative of a normal sales day. Petitioners urge that the Division was required to produce the two individuals who actually conducted the observation test. Petitioners also challenge the documents in the record purporting to be from the Robert Morris Associates survey as not identifiable. Petitioners argue that the auditor should have given credit for seasonal changes in sales and for being open less hours during weekdays. Petitioners

claim that more credence should have been given to their analysis of their daybook, even though there are little or no source documents in the record.

The Division agrees with the Administrative Law Judge's determination. The Division maintains that the use of an indirect audit method was proper and that petitioners did not establish by clear and convincing evidence that the tax assessed was erroneous or that the audit method was unreasonable.

### ***OPINION***

Where, as here, the Division properly requests and examines a taxpayer's books and records, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*see, Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138). The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness is not required (*Matter of W. T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of tax assessed was erroneous (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

Petitioners do not contest that their records were inadequate or that the Division was not entitled to resort to an estimated audit method. In this case, the Division conducted an observation test of petitioners' daily sales to arrive at petitioners' gross taxable sales for the day. This observation test would appear to have subsumed *all* of petitioners' sales, including sales of

German novelty items. However, the Division decided to separately audit petitioners' sales of German novelty items.

The Division's auditor testified that in her audit of German novelty items she utilized an industry index, the Robert Morris Associates Survey of retail gift or souvenir shops that sold similar items to estimate petitioners' sales tax liability. We note that petitioners' business, according to the audit report itself, was a delicatessen, not a souvenir shop. We also note that separately auditing sales of the novelty items after already conducting an observation test to determine petitioners' total daily sales would appear, in the absence of some explanation or justification, duplicative. In any event, there is a dearth of meaningful information about this industry index in the record to show how the underlying data was selected, compiled or manipulated. There is a copy of what appears to be a cover page of a publication in the audit papers, but it is illegible, i.e., it does not identify itself as being from Robert Morris Associates. Also in the audit papers, there are copies of pages taken from a publication purporting to be from that industry index, but they too do not identify their source. We have held that the record must contain information identifying the external index used by the Division to establish a rational basis for the audit methodology employed (*see, Matter of Fokos Lounge*, Tax Appeals Tribunal, March 7, 1991; *Matter of Fashana*, Tax Appeals Tribunal, September 21, 1989). Such information is necessary in order to provide petitioners with an opportunity to meet their burden of proving such methodology unreasonable. Accordingly, we conclude that that portion of the Division's audit asserting sales tax on German novelty items is without a rational basis and must be cancelled.

Except as provided for above, we affirm the determination of the Administrative Law Judge. We find that the Administrative Law Judge has fully and correctly addressed the remaining issues and arguments presented, and we can find no basis to further modify his determination in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Juergen Staekeler and Edelweiss International, Ltd. is granted to the extent that the portion of the assessment relating to sales tax on German novelty items is cancelled, but is otherwise denied;
2. The determination of the Administrative Law Judge is reversed in accordance with paragraph "1" above, but is otherwise affirmed;
3. The petitions of Juergen Staekeler and Edelweiss International, Ltd. are granted in accordance with paragraph "1" above and with conclusions of law "I," "K" and "L" of the Administrative Law Judge's determination, but are otherwise denied; and
4. The notices of determination, dated July 16, 2001 and July 18, 2001, are modified in accordance with paragraph "3" above, but are otherwise sustained.

DATED: Troy, New York  
November 23, 2005

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

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

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/s/Robert J. McDermott  
Robert J. McDermott  
Commissioner