STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MUHAMMAD S. ABBASI	:	DECISION DTA NO. 820239
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, 1999 through February 28, 2002.	:	

Petitioner, Muhammad S. Abbasi, filed an exception to the determination of the Administrative Law Judge issued on November 16, 2006. Petitioner appeared by Lawrence R. Cole, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioner filed a brief in support of his exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioner's request, was heard on December 12, 2007 in Troy, New York.

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

ISSUES

I. Whether the auditor's use of a rent-to-sales ratio provided a rational basis for the Division's estimate of petitioner's sales and for the resulting assessment of additional sales tax due from Muhammad S. Abbasi.

II. Whether petitioner has established any facts or circumstances warranting the reduction or abatement of penalties imposed.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. We have also made additional findings of fact. The Administrative Law Judge's findings of fact and the additional findings of fact are set forth below.

Petitioner, Muhammad S. Abbasi, operated a retail jewelry business known as Intrigue Jewelers, selling jewelry, including "costume" jewelry, made of silver, sterling silver and gold. This business was located in a ten foot by ten foot kiosk in the Broadway Mall in Hicksville, New York, with such space subleased by petitioner from Gold Concepts, Inc., a Texas corporation. The lease between the Broadway Mall and Gold Concepts, Inc. is dated August 24, 1999. The record does not contain a sublease document between petitioner and Gold Concepts, Inc., but according to petitioner he paid rent directly to Broadway Mall, as opposed to Gold Concepts, Inc.[1]

There appears to be no dispute between the parties that petitioner did not commence doing business at the subject location until approximately February 1, 2000. The first sales and use tax return for petitioner's business was filed under sales tax identification number B-59-3607425 (emphasis added), and covered the sales tax quarterly period spanning March 1, 2000 through May 31, 2000.

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[1] Petitioner also operated a similar business located in the Roosevelt Field Mall in Garden City, New York. However, the subject audit covered only petitioner's business operations at the Broadway Mall.

Petitioner operated the business on a day-to-day basis. Credit card sales were deposited directly into a business checking account at Astoria Federal Savings Bank. Sales paid for by cash or by check were allegedly deposited into the same account by petitioner on a periodic basis. There were also sales of merchandise left on consignment with petitioner, although the record contains no specific information concerning such sales. Sales tax returns were prepared by petitioner's accountant on the basis of the total amount of deposits made to the bank account.

By a letter dated April 2, 2002, an auditor for the Division of Taxation ("Division") advised petitioner that an appointment was scheduled for May 2, 2002 in order to commence a sales and use tax field audit of petitioner's business for the period spanning June 1, 1999 through February 28, 2002. The Division's letter requested that all of petitioner's books and records pertaining to the business for the audit period be available for review. Among the records specifically requested, as detailed in an attached Records Requested List, were the general ledger, cash receipts journal, federal income tax returns, purchase invoices, sales invoices, guest checks, cash register tapes, bank statements, financial statements and exemption documents. The initial audit appointment date of May 2, 2002 was changed at petitioner's accountant's request to May 16, 2002.

The Division's auditor made a pre-audit visit to the business location on April 17, 2002. Thereafter, on May 16, 2002, the auditor met with petitioner's accountant, at which time some bank statements, a few bank deposit slips, and a small number of purchase invoices were provided. Petitioner did not provide any other records, such as a general ledger, daybook of sales, cash receipts journal, cash register tapes, sales invoices, daily summary tapes, or the like.

Petitioner's accountant notified petitioner of the meeting with the auditor and, in turn, petitioner contacted the auditor, via e-mail dated October 28, 2002, seeking further clarification of the type of invoices required for audit review. The auditor, in turn, sent a responding e-mail to petitioner on October 29, 2002, further identifying and requesting specific records necessary for the conduct of the audit, as follows:

> What we need to correctly compute the tax that you owe is Sales Invoices and or Charge slips for every sale that you made. You did give me invoices from several suppliers which I did transcribe. Unfortunately you indicated that you take merchandise from certain suppliers on a consignment agreement whereby you get a commission for items sold and return the unsold items after a certain period of time. What we need to accurately understand your business activities is every purchase invoice from all suppliers including the consignment suppliers. We need to know how much of those goods were sold by you or not returned to your supplier.
>
> Mr. Ghori advised that this is what you are trying to obtain.
>
> In any event, you are paying a large amount of rent to your landlord or landlords. Having paid this substantial rent you show very little income being generated by the business. The question then becomes why you would continue to do business? In the absence of sales and or purchase records to tie into the amounts that you report on your Federal and State Income tax returns, we will have to use some sort of fair estimation of the sales that you made during our audit period. This would usually take into account the rent you are paying and what people in a similar business reports [sic].
>
> Unfortunately, I cannot tell you how or where to get the records at this time. The records should have been kept during the period in question. If you have not kept the records you will have to get them from the individuals that you did business with - both your suppliers and your customers.

No additional records were submitted by petitioner and, after reviewing the very limited records presented, the Division's auditor determined that they were not sufficient to allow the

conduct of a detailed audit and concluded that the use of indirect auditing methods to determine petitioner's sales would be appropriate. Most specifically in this regard was the absence of any source records of petitioner's sales (e.g., sales invoices), coupled with the auditor's review of petitioner's business bank records for the 11 month period spanning February 2000 through December 2000 which showed that total deposits ($197,085.08) exceeded gross sales for the business per petitioner's Federal income tax return for the year 2000 ($129,979.00) by more than $67,000.00.

The auditor utilized a rent factor method to determine petitioner's gross sales. Specifically, the auditor determined that petitioner's rent for the period February 1, 2000 through December 31, 2000 was $6,717.00 per month, based on petitioner's Federal income tax return for the year 2000, and that petitioner's rent for the period January 1, 2001 through February 28, 2002 was $6,250.00 per month, based on the lease for the premises. Total rent in the amount of $161,387.00 was thus calculated for the period February 1, 2000 through February 28, 2002. In turn, the auditor reviewed information from two "no change" audits recently performed for two other jewelry businesses in the same geographical area. In one such audit, gross sales were determined to have been 40 times the annual rent, while in the other gross sales were determined to have been 8 times the annual rent. The auditor selected a factor of 10 as the multiplier to determine gross sales in this instance, based on his experience and belief that a factor on the lower end of the range was appropriate. Using the foregoing information and methodology, the auditor calculated audited gross sales in the amount of $1,613,870.00. Petitioner presented no claim or evidence of non-taxable sales, thus all sales were presumed to have been taxable sales, and tax due thereon was calculated in the amount of $137,178.95.

Petitioner filed for and received two sales tax Certificate of Authority registration identification numbers for his business. The first Certificate of Authority was issued April 28, 2000 while the second was issued May 2, 2000.

Petitioner filed two sales and use tax returns under the first certificate number specifically for the sales tax quarterly periods ended May 31, 2000 ("return #101") and August 31, 2000 ("return #201"), and remitted tax therewith in the respective amounts of $3,172.00 and $2,838.00, for total tax remitted in the amount of $6,010.00.[2] The auditor reduced the amount of tax calculated as due on audit ($137,178.95) by allowing credit for the tax paid with the aforementioned two sales tax returns. However, the auditor erred in the transcription of the amount of tax paid by petitioner for the sales tax quarterly period ended August 31, 2000, such that credit was allowed only in the amount of $2,383.00 rather than in the amount of $2,838.00 as paid, a difference of $455.00. Thus, the auditor's work papers, and attendant calculation of additional tax due was premised on a credit of $5,555.00, rather than the correct amount of $6,010.00, resulting in audited additional tax due in the amount of $131,623.95.

In addition to the sales tax returns filed by petitioner under the first certificate number, petitioner also filed sales tax returns under the second certificate number as follows:

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[2] Identifying sales tax returns by a three digit number (e.g., "return # 101") provides reference to the sales tax quarterly period to which a particular return pertains. Under this system of identification, the first digit refers to the particular sales tax quarterly period, and the last two digits refer to the year in which the four sales tax quarterly period cycle will end (e.g., return #101 refers to the first sales tax quarterly period of the four period cycle which ends in the year 2001). The sales tax quarterly periods commence, under this system, with the period spanning March 1 through May 31. Hence, return # 101 pertains to the first sales tax quarterly period of the four period cycle ending in the year 2001 (i.e., spanning March 1, 2000 through May 31, 2000), return #201 pertains to the second sales tax quarterly period of the year 2001 (i.e., spanning June 1, 2000 through August 31, 2000), return #301 pertains to the third sales tax quarterly period (i.e., spanning September 1, 2000 through November 30, 2000), and return #401 pertains to the fourth and final sales tax quarterly period of the cycle (spanning December 1, 2000 through February 28, 2001).

Three Digit Return Identifier	Sales Tax Quarterly Period	Sales Tax Amount
101	03/01/00 through 05/31/00	$3,172.00
301	09/01/00 through 11/30/00	$3,399.00
401	12/01/00 through 02/28/01	$4,626.00
102	03/01/01 through 05/31/01	$2,249.00
302	09/01/01 through 11/30/01	$ 0.00

Review of the foregoing reveals that a return for the sales tax quarterly period spanning March 1, 2000 through May 31, 2000 ("return #101") was filed under both sales tax identification numbers, though there is no indication or evidence that duplicate payment of sales tax was made for such quarterly period.

The Division issued to petitioner a Notice of Determination dated March 4, 2004, assessing additional sales tax due for the period December 1, 1999 through February 28, 2002 in the amount of $131,623.95, plus interest and penalties, including an omnibus penalty pursuant to Tax Law § 1145(a)(vi) for underreporting tax liability in excess of 25% of the amount of tax required to be shown on a return.[3] As noted previously, although the full audit period spans June 1, 1999 through February 28, 2002, the Division did not assess any tax, penalties or interest for the first two sales tax quarterly periods thereof in light of the fact that petitioner did not commence business operations until February 1, 2000. It is further noted that in view of the transcription error described above (***see***, Finding of Fact above), the Notice of Determination

[3] Petitioner executed consents extending the period of limitations on assessment so that the Division was entitled to assess sales and use tax liability for the period June 1, 1999 through February 28, 2002 at any time on or before September 20, 2004.

should be reduced by the amount of $455.00, so that the resulting amount of tax assessed and remaining at issue herein is $131,168.95, plus interest and penalties.

Petitioner also submitted a sales tax return for the quarterly period ended August 31, 2001 ("return # 202") under the first certificate number. This return, which showed zero gross sales and zero sales tax as due, was marked "final" on its face. This return was accompanied by a copy of the sales tax Certificate of Authority for Muhammad S. Abbasi/Intrigue Jewelers, 3507 Broadway Mall, Hicksville, New York 11801 under the second certificate number. The area of the Certificate of Authority in which to provide information to the Division in the event a business is sold or discontinued or changes its status reflects May 31, 2001 as the last day of business for Muhammad S. Abbasi d/b/a Intrigue Jewelers, lists New Intrigue Jewelers, Inc. (emphasis added) as the new business name, and reflects the same 3507 Broadway Mall business address. Check boxes on the Certificate of Authority to indicate that a business was sold, discontinued or changed in status were left blank.

A filing receipt from the New York State Department of State and a Certificate of Incorporation reflect the formation of the corporation New Intrigue Jewelers, Inc. and the filing of its certificate of incorporation as having occurred on April 24, 2001 and April 25, 2001, respectively. The auditor's notes from the initial audit appointment reflect that the auditor was informed of this change of business form from a proprietorship to a corporation, and that the corporation applied for a sales tax Certificate of Authority (and identification number) on or about August 1, 2001.

Petitioner incorporated his business at the suggestion of his accountant, and continued to operate the business at the same 3507 Broadway Mall location after its incorporation until

approximately August 2002, at which time petitioner ceased operations in the Broadway Mall. After incorporation, petitioner was the president and sole shareholder of the corporation, signed tax returns on behalf of the corporation and controlled its books and records. The initial sales tax return for New Intrigue Jewelers, Inc. was filed for the sales tax quarterly period ended August 31, 2001 and shows taxable sales of $26,446.00 in Nassau County with a sales tax liability (after reduction for a vendor collection credit) in the amount of $2,210.89.

As noted, the business utilized a business checking account maintained at the Astoria Federal Savings Bank. Monthly statements for this account from the beginning of the audit period through September 2001 were in the name Intrigue Jewelers, 3507 Broadway Mall, Hicksville, New York. Commencing in October 2001 and continuing through the end of the audit period, monthly statements for this same account were in the name New Intrigue Jewelers, Inc. at the same address. The record includes a corporate resolution, dated October 16, 2001 and signed by petitioner under the title of corporate secretary, as filed with Astoria Federal Savings Bank to authorize the change of name to New Intrigue Jewelers, Inc. There is no apparent entry for a check drawn on this account, under either the name of Intrigue Jewelers or New Intrigue Jewelers, Inc., in payment of the $2,210.89 sales tax amount listed above for the sales tax quarterly period ended August 31, 2001.

Petitioner submitted copies of two checks drawn on the Intrigue Jewelers account at Astoria Federal Savings Bank and payable to New York State Sales Tax. Check number 1171, in the amount of $4,626.02, is dated March 18, 2001, while check number 1187, in the amount of $2,249.50, is dated June 18, 2001. The memo section of each check indicates that it is for the sales tax identification number of the second certificate. There is a deposit serial number on the

face of each check, and the reverse side of each check indicates that each of the checks has been "paid". According to the Division, check number 1171 pertains to the sales tax quarterly period ended February 28, 2001 and to a sales tax return filed for such period ("return # 401"), while check number 1187 pertains to the sales tax quarterly period ended May 31, 2001 and to a sales tax return filed for such period ("return #102"). The Division explained that these checks were placed in a "suspended payment" file due to the use of the sales tax identification number of the second certificate. Hence, the Division conceded that no credit for such payments was allowed with respect to the sales tax identification number of the first certificate, under which the Notice of Determination herein was issued. The Division further advised that it will, "upon direction by petitioner and assuming the checks are honored," apply these checks totaling $6,875.52, toward any liability found due herein with respect to the sales tax identification number of the first certificate.[4]

In the same manner, review of the Division's sales tax filing and payment records in evidence, from which the foregoing filing and payment information is taken, also reveal that two additional sales tax returns were filed by petitioner under the sales tax identification number of the second certificate (***see***, Finding of Fact above). The first of these returns pertains to the sales tax quarterly period ended November 30, 2000 ("return # 301"), and was accompanied by payment in the amount of $3,399.00, while the second such return pertains to the sales tax quarterly period ended November 30, 2001 ("return #302"), and was not accompanied by any payment. While the record does not include a copy of a canceled check with regard to the first of

[4] The Notice of Determination herein was issued under sales tax identification number of the first certificate. Given that the checks in question have been paid, and that petitioner has challenged such Notice of Determination in this proceeding, it follows that such checks have been "honored" and that petitioner would "direct" application of such amounts against any liability found due herein.

such filings and accompanying payment, the Division's records are consistent and identical in comparison to the two earlier returns for which credit is being afforded (return #401 and return #102), specifically in that a deposit serial number is reflected for each filing and payment. Further, there is no evidence or claim that such payment was dishonored. Accordingly, and consistently, it is appropriate that credit be allowed for such payment in the amount of $3,399.00 made under the sales tax identification number of the second certificate for the quarterly period ended November 30, 2000, toward any liability found due herein with respect to the sales tax identification number of the first certificate.

Petitioner claimed that he maintained complete records, including all sales invoices, and that he submitted the same to the auditor. However, the testimony in this regard was unclear and equivocal at best, with petitioner first claiming to have given such sales records (i.e., credit card slips and summary tapes) to his accountant to provide to the auditor. However, when petitioner was shown a letter by his accountant noting that the accountant had given the auditor bank statements (as opposed to sales invoices), petitioner stated that he (petitioner) had provided the sales invoices directly to the auditor. In any event, the only sales records provided in evidence consisted of seven credit card sales receipts for sales made on April 7, 2001, and an accompanying cash register summary tape for such date listing the same credit sales for this one day. No other such source records of credit card sales for any other days were provided, nor were any source records of sales by cash or check provided for any days.

We make the following additional findings of fact:

> The Division's auditor testified on direct examination concerning his estimation methodology as follows:
>
> Q. What audit methodology did you then employ?

A. Our experience on similar type businesses and the way that we proceeded on similar type businesses was to use a rent factor, and the most common one that we kind of start out with a benchmark kind of thing was ten times rent.

Q. Where did that figure come from?

A. Originally we used that on flea market type operations – well, other things too – but we found through various published statistics and our experience that that was a good benchmark figure and it was used regularly on flea market operations that we used to do.

Q. Was it used regularly in your office?

A. Yes (Hearing Transcript, pp. 27-28).

The auditor testified further that it had audit information about two other businesses "that were fairly similar in geographic location and type of operations to the vendor's business" and that "copies of the information pertaining to those business [is] contained in the audit work papers" (Hearing Transcript, p. 30).

The Division's audit workpapers introduced as Exhibit "G-1" include several pages of print-outs apparently related to sales tax audits of other businesses. The first describes the business class as "retail book & stationery store." The second describes the business class as "retail book & stationery store." The third describes the business class as "retail book & stationery stores." The fourth describes the business class as "miscellaneous repair services." The fifth describes the business class as "retail jewelry stores."

The Division's Field Audit Record (Exhibit "E") includes the following entries:

Vendor was selected for audit based on a taxpayer complaint. Complaint stated that vendor offered not to charge tax if customer paid in cash.

* * *

The amount due on audit was computed by multiplying the rent by a factor of 10 . . . . A review of two Jewelry Store audits found rent to sales ratios of 2.40% and 12.5% respectively. Therefore the 10 times rent seems reasonable.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The determination of the Administrative Law Judge reviewed the law governing sales tax audits and concluded that petitioner's books and records were insufficient. Accordingly, he concluded that the auditor properly resorted to external indices to determine petitioner's sales and sales tax liability. The determination further found that an estimation method based on multiplying rent by a factor to find the amount of sales was specifically authorized by the Tax Law and the applicable cases. Moreover, the Division was not required to use a bank-deposit analysis or an observation test on the theory that those alternative methods might have produced a more accurate result.

The determination also made some computational adjustments in the tax amount and cancelled the asserted deficiency for the final two quarterly periods during which the business was conducted by a corporation to which the Division had not issued an assessment.

Finally, the determination found that there was no basis upon which penalties should be reduced or abated and accordingly the asserted penalties were sustained.

ARGUMENTS ON EXCEPTION

In support of his exception, petitioner asserts that 90% to 95% of petitioner's sales were paid for with credit cards and that credit card sales receipts were deposited directly into his bank account. Petitioner also claims that he maintained and made available to the auditor adequate books and records.

Petitioner argues that the Division's audit methodology was unreasonable since petitioner's ten by ten foot kiosk was not comparable to a jewelry store because the rent for such a booth would include utilities and other overhead items that might be excluded from a store's

rent. Moreover, the confidential nature of information about the purportedly comparable businesses made it impossible for petitioner to address the issue.

Finally, petitioner asserts that there is no basis for the assessment of penalties based on willful intent or neglect since he timely paid all taxes due and presented all books and records on audit.

In opposition to petitioner's exception, the Division asserts that petitioner's argument that complete books and records were provided is without any basis in fact. Accordingly, an indirect method of determining sales and the resulting tax liability was authorized. With respect to the use of a rent factor, the Division's brief (Brief in opposition, p. 5) argues as follows:

> The rent factor employed was selected based upon the auditor's office experience. This is a valid basis for audit conclusions. **Matter of A&J Gift Shop v Chu**, 145 AD2d 877, lv den 74 NY2d 603 (rent factor of 10); **Matter of Convissar v State Tax Commission**, 69 AD2d 929; **Matter of Giordano v State Tax Commission**, 145 AD2d 726; **Matter of Oak Beach Inn Corp. v Wexler**, 158 AD2d 785.

The Division also asserts that the imposition of penalties was appropriate.

OPINION

The standard for reviewing a sales tax audit where external indices were employed is as follows. The Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment. The purpose of the examination is to determine, through verification drawn independently from within these records, whether they are in fact so insufficient that it is virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit from which the exact amount of tax due can be determined. Where the Division follows this procedure, and thereby demonstrates that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax.

The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness in the outcome of the audit method is not required. The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous or that the audit methodology is unreasonable. In addition, considerable latitude is given an auditor's method of estimating sales under such circumstances as exist in each case (***see, Matter of Your Own Choice***, Tax Appeals Tribunal, February 20, 2003; ***Matter of AGDN, Inc.***, Tax Appeals Tribunal, February 6, 1997).

As a general principle, the conduct of government proceedings based on secret information, which the individual citizen has no opportunity to challenge or even examine, strongly suggests the absence of fairness. Accordingly, in order to impose on petitioner the heavy burden of proving by clear and convincing evidence that the audit methodology is unreasonable, it is not sufficient for the Division simply to present an estimated dollar amount of sales and to state that it is based on the Division's "experience." Instead, the record must contain sufficient evidence to enable the trier of fact to determine whether the audit has a rational basis, as well as specific information identifying the external index employed by the Division in estimating tax liability (***see, Matter of Grecian Sq. v. New York State Tax Commn***., 119 AD2d 948 [3d Dept 1986]; ***Matter of Spallina***, Tax Appeals Tribunal, February 27, 1992; ***Matter of Fokos Lounge***, Tax Appeals Tribunal, March 7, 1991; ***Matter of Fashana***, Tax Appeals Tribunal, September 21, 1989; ***Matter of Savino***, Tax Appeals Tribunal, September 22, 1988).

In ***Grecian Square***, the court stated in part as follows:

> Here, respondent's auditor [McKenna] found petitioner's sales figure to be much lower than other establishments which he had audited. Accordingly, he increased petitioner's estimated sales figure by 200%. However, the record does not disclose any specific information concerning the bars

> which McKenna had audited and found to have been comparable to petitioner's. As best as we can determine, no such information was given petitioner in advance of the hearing. At the hearing, McKenna merely stated that he had estimated sales by calling upon his wide experience in auditing other bars. Considerable latitude is given an auditor's method of estimating sales under such circumstances as exist in this case. Nevertheless, there was insufficient evidence before respondent to determine whether a rational basis existed for the auditor's computation. By the same token, without some information about the size, location, number of employees and nature of the operation, this court is unable to make a determination as to the existence of a rational basis (119 AD2d, at 950 [citations omitted]).

In ***Fokos Lounge***, we rejected as lacking a rational basis an estimate of sales based on the taxpayer's utility bills "due to the absence of any correlation whatsoever between the level of utilities and the gross sales of the business" and an estimate based on rents where statistical charts showing rents as a percentage of revenues did not "reveal any meaningful information as to how the underlying data was selected, compiled or manipulated." An estimate of sales based on a salaries and wages factor was similarly rejected in ***Fashana*** where the Division relied on statistical charts for various industries, which were purportedly derived from Federal income tax returns but did not reveal the authorship or methods by which the charts were created.

In the present case, the Administrative Law Judge determined that the auditor had the authority to use petitioner's rent as a basis for projecting sales since "[s]uch method is specifically provided for under the second sentence of Tax Law § 1138(a)(1), and its application by the Division has been upheld as valid in numerous instances (***see, Matter of A & J Gifts Shop v. Chu***, 145 AD2d 877, 536 NYS2d 209 [(3d Dept 1988), ***lv denied***, 74 NY2d 603 (1989)])." Tax Law § 1138(a)(1) reads in pertinent part as follows:

> If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the commissioner from such information as may be available. If

> necessary, the tax may be estimated on the basis of external indices, such as stock on hand, purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service, number of employees or other factors.

The taxes imposed by Article 28 of the Tax Law apply to receipts from the retail sale of tangible personal property (Tax Law § 1105[a]) and to receipts from the sale of various listed services (Tax Law § 1105[b], [c], [d], [e], [f]). Some of these receipts are in a form that is referred to in the statute as "rent" or would normally be referred to as "rent" in common parlance. For example, the terms "sale, selling or purchase" are defined in section 1101(b)(5) to include "rental" and "lease." Section 1105(c)(4) applies to receipts from "storing tangible personal property . . . and the rental of safe deposit boxes or similar space." Section 1105(c)(6) applies to receipts from "[p]roviding parking, garaging or storing for motor vehicles." Section 1105(f)(1) applies to receipts from "rent for every occupancy of a room or rooms in a hotel." In light of these provisions, it could be argued that when section 1138(a)(1) refers to "rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service" as the basis for an estimate, it is intended to apply in circumstances where the subject of the tax is itself rent and that the terms "stock on hand [and] purchases" are intended to apply where the tax is applicable to sales of merchandise in a retail shop, as in the present case. Nevertheless, the items listed in section 1138(a)(1) are preceded by the words "such as" and followed by the words "or other factors" and are clearly intended to be merely nonexclusive examples. What we do infer, however, is that the thing on which the estimate is based should be logically and empirically related to the subject of the tax and that finding that thing listed as a possible factor in section 1138(a)(1) does not authorize its use in all possible circumstances. For example, the statutory listing of "stock on hand" as a possible factor does not necessarily support

an estimation of the room rental receipts of a hotel based on the number of towels in its inventory in the absence of some further explanation of why revenues of a hotel can be expected to vary in some predictable way in relation to the towel count. Rent-to-sales ratios have been found to provide a rational basis for estimating sales in several cases that are discussed below.

In ***Matter of A & J Gifts Shop v. Chu, supra***, the court approved the Division's estimate of sales at flea markets and yard sales based on a formula of ten times rental expense. The court described the external index used as follows:

> The external index used was developed based upon a special flea market program carried out by the Department. Initially, sales were calculated based upon a Dun and Bradstreet report which found rent to generally be 4% of the cost of doing business. Accordingly, sales were calculated to be 20 times the rent. This gross sales figure was adjusted downward to 10 times the rent on the basis of the Tax Commission's experience with the flea market program and audits of similar vendors in the industry. An error figure was also utilized to calculate the final sales tax due. This method cannot be said to be unreasonable. It was developed specifically for flea markets and adjusted when found to be too high (145 AD2d, at 878).

(The other decisions of the Appellate Division on which the Division relies, ***Convissar***, ***Giordano***, and ***Oak Beach Inn*** involved audit methodologies based on marking up the vendor's purchases by a profit factor and not an estimate based on rent-to-sales ratios).

In ***Matter of Constantini,*** Tax Appeals Tribunal, January 10, 2008, we approved the use of a rent factor as an external index based on statistical information found in a standard reference for businesses of the same type as the taxpayer's–*viz.* "pasta restaurant/pizza take-out establishment."

In ***Matter of Your Own Choice, supra***, we approved the use of a rent factor in circumstances described as follows:

Noting that petitioner's annual rent for its business premises was readily apparent on the face of its Federal income tax returns for each fiscal year falling within the audit period, the Division consulted a publication entitled "Cost of Doing Business - Corporations" for fiscal year July 1987 to June 1988 and published by the Dun & Bradstreet Corporation. This publication is a self-described "guide to selected operating expenses for corporations" which covered 191 lines of business. The tables within the publication set forth the average amount spent by corporations for 11 selected operating expenses, including rent paid on business property, for each of the 191 business lines, expressed as a percentage of business receipts reported by a representative sample of all corporate Federal income tax returns filed for 1987. The table chosen by the auditor included a group of business lines headed "Retail Trade," which group includes the business line "Food Stores." This table reveals that food stores doing business in the corporate form, on average, pay as rent an amount that is equal to 1.73 percent of their business receipts.

Based on the office experience of the auditors, the ratio of taxable sales to gross sales of a convenience store or corner grocery store can be as high as 70 or 80 percent, while that of a supermarket can range from about 29 percent to 38 percent.

The Division, in the course of its audit, assumed a taxable ratio of 29.7 percent for petitioner, and it is assumed further that petitioner's rent was 1.73 percent of its reported gross sales. Using these figures, the Division compiled a test computation of petitioner's additional taxable sales for the audit period of $1,839,915.88 and additional sales tax due thereon in the sum of $151,793.06.

* * *

The reasons given by the Division for its adoption of the 10 percent rent factor in place of 1.73 percent from the Dun & Bradstreet study was out of consideration of a number of factors bearing on the volume of petitioner's business, including its location in a commercial neighborhood with plenty of competition that served to reduce traffic in the store and the Division's inability to rule out that petitioner's gross sales included Lottery commissions.

In ***Matter of Bitable on Broadway***, Tax Appeals Tribunal, January 23, 1992, ***confirmed*****,** 199 AD2d 633 (3d Dept 1993), we approved the use of a rental factor that was determined as follows:

> Based upon the auditor's determination that petitioner did not have complete books and records for the audit period and that, under such circumstances, a complete and detailed audit could not be performed, he selected an audit method utilizing a rent factor obtained from the National Restaurant Association's Restaurant Industry Operations Report for 1987. Pursuant to this report, the rent factor for the upper quartile (the auditor was instructed to use the upper quartile by his group chief) of the northeast region was 7.1 percent. The document introduced into evidence at the hearing consisted of a title sheet along with two pages (presumably relating to restaurants with full menu table service) setting forth ratios to total sales of various income and expense factors with rent, property taxes, other taxes and property insurance constituting the category of occupation costs.

In approving the use of the rent factor, we concluded that it was sufficient for the Division to identify the statistical report on which its calculations were based since the report was publicly available and the taxpayer would thus be able to introduce evidence challenging the soundness or applicability of the report. The decision specifically distinguishes "those cases where the audit methodology is based on facts that are peculiarly within the knowledge of the Division, e.g., audits of similar establishments, where the Division has the obligation to describe these facts in response to the petitioner's inquiries at hearing (see, Matter of Basileo, Tax Appeals Tribunal, May 9, 1991)."

In ***Matter of Basileo***, ***supra***, the Division estimated a restaurant's sales by "obtaining figures for two other restaurants each deemed to be comparable to petitioner's restaurant . . . and averaging them." As in the present case, the two other businesses were not identified since the data involved confidential taxpayer information. In concluding that the Division's methodology lacked a rational basis, we stated in part as follows:

> The audit methodology employed by the Division in this case was purportedly a comparison of petitioner's restaurant to two other "substantially and materially similar" . . . restaurants. The amount of tax due in this case was calculated as an average of the audited sales of the

> two other restaurants. However, the record is void of any evidence that describes any aspect of these two restaurants. Thus, the record does not provide any basis to evaluate the comparison between petitioner's restaurant and the two other restaurants utilized by the Division. In addition, the record does not indicate what kind of audit was performed of the other two restaurants. . . .
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> * * *
>
> 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. We also conclude that the Division must, at hearing, through witnesses or documents, be able to respond meaningfully to inquiries regarding the nature of the audit performed. Such information is necessary in order to provide petitioner with an opportunity to meet its burden of proving such methodology unreasonable. Since the Division was unable to provide such responses at this hearing, we conclude that the audit is without rational basis and the taxpayer sustained its burden to show that the audit methodology was unreasonable.
>
> Finally, a remand of this case would not be appropriate because the Division has had ample opportunity, through the repeated questions posed at the hearing, to describe the specifics of the instant audit and has simply been unable to do so (Citations omitted).

In the present case, we are similarly presented with limited information about two retail businesses located in Nassau county and are asked to treat the data as if it were the product of a statistical sampling from which we might draw a rational inference about petitioner's revenue from sales. The fact that the rent-to-sales ratio of one of the businesses was more than five times greater than that of the other seems to confirm the unreliability of this information for the purpose of projecting sales revenue. As in ***Basileo***, the Division's auditor was unable on cross examination to provide a detailed description of the two purportedly comparable taxpayers (***see***, Hearing Transcript, pp. 87-99).

In each of the cases referred to above in which rent-to-sales ratios have been found to provide a rational basis for estimating a petitioner's sales, the Division has begun with a broad

sampling drawn from its own experience or standard reference works and then tailored that information to make it more comparable to the matter at hand. Although the logical and empirical connection between rental expense and sales revenue generally seems weak, in each case meaningful information was provided as to how the data underlying the rent factor were selected, compiled or manipulated and as a result the petitioner was given a full opportunity to challenge the validity and application of the rent factor. Here, the auditor began and ended his analysis with "a benchmark kind of thing" of ten times rent, which was apparently drawn from flea market audits and "regularly used" in his office. The habits of mind so described do not in our view provide the required rational basis for estimating tax liability. The auditor's subsequent attempt to rationalize his conclusion by reference to two other audits is similarly unpersuasive.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Muhammad S. Abbasi is granted;

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

3. The petition of Muhammad S. Abbasi is granted; and

4. The Notice of Determination dated March 4, 2004 is cancelled.

DATED:Troy, New York
June 12, 2008

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

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

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