

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

---

In the Matter of the Petitions :  
of :  
**2720 HENRIETTA - BRIGHTON, INC.** : DECISION  
**AND WANG Y. HWANG, AS OFFICER** : DTA Nos. 822750  
: and 822751  
for Revision of Determinations or for Refund of :  
Sales and Use Taxes under Articles 28 and 29 of :  
the Tax Law for the Period March 1, 2004 through :  
May 31, 2007. :

---

Petitioners, 2720 Henrietta - Brighton, Inc. and Wang Y. Hwang, as officer, filed exceptions to the determination of the Administrative Law Judge issued on June 3, 2010. Petitioners appeared by Petralia, Webb & O'Connell, P.C. (Arnold R. Petralia, Esq., of counsel). The Division of Taxation appeared by Mark Volk, Esq. (David Gannon, Esq., of counsel).

Petitioners filed a brief in support of their exceptions. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on November 17, 2010, in New York, New York.

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

***ISSUES***

I. Whether it was appropriate for the Division of Taxation to use an indirect audit methodology.

II. Whether, assuming the use of an indirect audit methodology was proper, petitioners have shown error in the audit method or result.

III. Whether petitioners have established any facts or circumstances warranting the reduction or abatement of the penalty.

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner 2720 Henrietta - Brighton, Inc., was a full-service Japanese restaurant with a small bar. It served hibachi and sushi cuisine. Petitioner Wang Y. Hwang owned a controlling interest in the restaurant.

On January 11, 2007, the Division mailed an appointment letter to the restaurant stating that its sales and use tax records had been scheduled for a field audit for the period March 1, 2004 through November 30, 2006. The letter stated that “[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date.” A schedule of the books and records to be produced was attached to the letter. Subsequently, the audit period was amended to include the periods through May 31, 2007.

The Division found that the records that were subsequently produced were not sufficient to perform a detailed audit. The cash register tapes bore an erroneous year and did not show the day of the month. Nevertheless, the Division attempted to correlate the guest checks to the tapes for a particular month during the audit period. The Division found that there were guest checks on days where there were no entries on the tapes and there were days where there were cash register tapes but no guest checks. Its review led the Division to conclude that the tapes could not be used for an audit.

The Division also determined that there were numerous gaps and missing checks in the

sequence of the guest checks. Further, there was a wide variation in the number of missing checks within a gap. There were days where the guest checks were completely missing. In some instances, the restaurant was missing a large number of checks and in other instances, it was missing just a few checks. When the Division examined the guest checks, it found that it was of greater concern when the restaurant was missing a few checks within a book than when there was a gap of 100 or 500 checks, because this could be attributable to using a book of checks out of sequence. The audit workpapers show that most of the gaps in the sequence of checks, including large gaps, were of odd numbers.

The Division conducted an analysis of cash deposits and determined that the restaurant deposited only 5 to 13 percent of its cash receipts.

The one item that the Division believed that it had a clear record of was credit card sales. Therefore, the Division decided to use an observation test and from that observation test, calculate a cash-to-credit ratio and apply it to credit card sales. The Division felt that by using credit card sales to estimate total sales, it would account for fluctuations in total sales during the audit period.

On September 15, 2007, which was a Saturday, the Division conducted an observation of the restaurant. On this day, the restaurant was open from 4:00 P.M. until approximately 10:00 P.M. The individuals conducting the observation watched the restaurant from approximately one-half hour before opening until approximately one-half hour after closing. During the observation, the auditors recorded every sale and noted whether the purchase was by cash or credit card. The sales information was then provided to the auditor and the auditor's supervisor for analysis. The auditor found that during the observation period, cash sales constituted 35.83

percent of sales and credit card sales constituted 64.17 percent of sales. The Division then subtracted the tips from the credit card sales to determine the credit card sales without tips or tax. This amount was then divided by the cash-to-credit ratio of 64.17 percent to calculate the audited total sales and then total sales per quarter. The Division subtracted the reported gross sales from the audited gross sales to find the unreported gross sales. The remainder was then multiplied by the tax rate to calculate the amount of tax due. The sum of the amounts of tax due for all quarters was \$27,041.95.

On the basis of the forgoing audit, the Division issued a Notice of Determination (L-029603255-9), dated January 17, 2008, to the restaurant that assessed sales and use tax in the amount of \$27,041.95 plus penalty and interest for a balance due of \$43,631.94. On January 18, 2008, the Division also issued a Notice of Determination to petitioner Young Hwang Wang (L-029607362-3) that assessed the same amount of tax plus penalty and interest. Each notice imposed a penalty pursuant to Tax Law 1145(a)(1)(i) for failure to timely pay the tax imposed by Articles 28 and 29 of the Tax Law.

The sales volume on the day selected for the audit was very high. The Division felt that a high sales volume would lead to a more accurate statistical sampling for the credit-to-cash analysis. The observation was limited to one day because it was also the team leader's understanding that it was audit policy to conduct an observation test for one day rather than a more extended period.

The restaurant kept guest checks stacked in a closet at the front of the restaurant. When a party was seated, the host would leave a check at the table. In general, one guest check was used for each party. The restaurant did not try to keep guest checks in any particular order except to

the extent that it tried to keep the last two numbers on the guest checks in order.

There are several reasons why a gap in the sequence of the guest checks might occur. The gaps of 100 or 500 probably arose from the way the guest checks were removed from the box and stacked. If the restaurant ran out of checks, the bookkeeper would go to an office supply store and purchase more checks for the restaurant. Consequently, the checks were not always from the same supplier. If the guests at a particular table requested separate checks, the server would sign a sheet and bring the additional checks to the table. The original check would be voided and might be thrown away. On other occasions, a customer might ask to keep the check for his records. The bookkeeper felt that once a guest check was processed by a credit card machine, it was no longer needed and the customer was welcome to retain it.

The bookkeeper kept the guest checks in separate monthly piles, and whenever she had a chance, she would write the total sales for each day in a journal that allocated the sales into different categories such as food, liquor, beer and wine and soda. In order to prepare the sales tax returns, the bookkeeper sent a facsimile of a spreadsheet with the daily sales to the restaurant's accountant, Mr. Nacca. Thereafter, these amounts were reported by the accountant on the sales tax returns.

It is the bookkeeper's impression that there were relatively more credit card transactions during the week compared to the weekends because there are more business people eating out during the week and they tend to use credit cards. There are more couples and families on weekends.

The restaurant kept a certain amount of cash in the register in order to operate. The amount of cash varied from time to time but it would have been at least \$500.00. Only cash sales

were rung up on the cash register. The cash register was operated by the hostess and, if the hostess was busy, by the bartender. The reason the restaurant followed this practice is that there were frequently new people working at the restaurant and it tried to keep its procedures as simple as it could for them.

On occasion, the restaurant would cash a check for an employee and then deposit the check into the restaurant's account. This was done as a courtesy for employees who did not have bank accounts or for employees whose bank was closed when they received their checks. On credit card sales, the restaurant also cashed tips for its servers.

The restaurant's sales tax returns were prepared by Joseph Nacca, CPA. Before a return was due, Mr. Nacca's office contacted the restaurant to make sure that the restaurant either dropped off or faxed the information needed to prepare the return before the due date. After the returns were prepared, they were submitted to the client for signature and payment before the due date. In this case, Mr. Nacca received a daily sales journal for each month of the sales tax quarter from the restaurant, which, in turn, was used to prepare the sales tax returns.

In addition to the sales journal, Mr. Nacca's office also received, on a quarterly or semiannual basis, the disbursements journal and bank statements, which might include cancelled checks depending upon the bank involved. Mr. Nacca's office reconciled the bank statements in order to obtain a cash balance. When he reviewed the bank balance, he did not examine any of the credit card deposits.

Using the guest checks for the dates of September 9, 2007 through September 14, 2007, Mr. Nacca performed an analysis of guest checks and found that credit card sales comprised 71.72 percent of total sales during this period of time and the balance of 28.28 percent were cash

sales. These percentages would have resulted in an underpayment of sales tax of \$9,600.00. Mr. Nacca opined that if the test were expanded to a longer period of time, it would have shown that even less tax was due. When this analysis was presented to the Division, Mr. Nacca was told that since the Division did not observe the restaurant on these days, it could not use the analysis.

In Mr. Nacca's opinion, he provided everything that the Division requested.

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

The Administrative Law Judge noted the statutes and case law regarding sales tax audits and determined that the Division made proper records requests, thoroughly examined the provided documents, and properly determined the records to be insufficient to conduct a full audit. The Administrative Law Judge found that the Division was entitled to resort to an indirect audit methodology to estimate petitioners' tax liability.

The Administrative Law Judge rejected petitioners' contention that its guest checks were sufficient to conduct an audit because taxable sales and receipts could not be independently verified from these records, given petitioners' practices of not utilizing consecutively numbered checks, discarding voided checks, and permitting customers to leave with the checks, which were the only original records, of sales. The Administrative Law Judge considered the remainder of petitioners' arguments and found them either without merit or unsupported by the record.

Accordingly, the Administrative Law Judge sustained the Notices of Determination in their entirety.

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

Petitioners raise the same arguments on exception as they did below. Petitioners argue that the Division was not entitled to use an indirect audit methodology because the guest checks

were sufficient to conduct a full audit. Petitioners also assert that the Division failed to conduct a thorough audit because they failed to question petitioners regarding the missing or duplicate guest checks. Further, they argue that the Administrative Law Judge erroneously accepted the Division's work papers, particularly the spreadsheet, into evidence because these documents lacked foundation. Petitioners also argue that, if the Division was entitled to estimate their tax liability, the one-day observation test was erroneous and produced an incorrect estimate. Petitioners seek cancellation of the subject Notices of Determination, or modification of the deficiency in accordance with the data submitted by their accountant.

The Division argues that the Administrative Law Judge properly determined that petitioners failed to produce adequate books and records and that the audit methodology was reasonable. The Division also argues that petitioners failed to provide the requisite reasonable cause for the abatement of penalties. Accordingly, the Division requests that we affirm the determination and sustain the Notices of Determination issued to petitioners.

### ***OPINION***

We have often restated the standard for reviewing a sales tax audit where the Division estimates sales tax liability. In *Matter of Your Own Choice* (Tax Appeals Tribunal, February 20, 2003), we stated as follows:

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn., supra*) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied*

44 NY2d 645, 406 NYS2d 1025; *see also*, *Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is “virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit” (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), “from which the exact amount of tax due can be determined” (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, “[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case” (*Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

The Administrative Law Judge properly concluded that the Division made a proper records request. Petitioners provided credit card sales documents, some bank statements, some cash register tapes, and a voluminous amount of guest checks. The cash register tapes were properly determined insufficient to conduct a full audit because they recorded only cash sales and were improperly dated. Similarly, the Division determined that the bank statements were not reliable because the cash deposited did not correlate to the generated cash sales. The remaining records at issue are the guest checks submitted by petitioners.

Petitioners argue that this case is similar to *Matter of King Crab* (*supra*) and that the voluminous guest check records are sufficient to conduct a full audit. In *Matter of King Crab*

(*supra*), the Division audited the taxpayer and found that it did not maintain cash register tapes for the first seven months of a 34-month audit period. The auditor did not check to see whether all the guest checks were available for the seven months at issue, but instead conducted a spot-check of one box of guest checks and found them not to be in chronological order. The Court held that the Division was not entitled to estimate the taxpayer's liability because the lack of cash register tapes and the spot-check did not constitute a full and complete audit (*Matter of King Crab, supra* at 52-53). The core of petitioners' argument is that the Division was not entitled to estimate their sales tax liability because had they properly reviewed the guest checks, they would have found that they were sufficient to conduct a full audit. We disagree.

We hold that the Administrative Law Judge properly determined that the Division conducted a complete review of the guest checks. Initially, we note that this case is dissimilar from *Matter of King Crab* because the Division did not conduct a spot-check, but reviewed the provided guest checks in their entirety.<sup>1</sup> The audit file reveals that the Division examined each of the checks and keyed them into a spreadsheet. The Division reviewed the checks and the spreadsheet and found gaps in the guest checks record. Although some gaps might have been explained by petitioners having used entire check books out of numerical order, or because checks were purchased from a different supplier, contrary to petitioners' argument, a review of the spreadsheet shows other large gaps of checks that are not divisible by 100 and gaps within books of smaller numbers of checks.

Petitioners' arguments are insufficient to explain or otherwise cure the gaps in the guest

---

<sup>1</sup> We note that the guest checks submitted into evidence at the hearing do not appear to be all of the checks submitted to the Division.

check records. We must reject petitioners' contention that the gaps in the record correspond to credit card sales because this claim cannot be verified against credit card charges without the actual missing guest checks. We further note that, at the hearing, petitioners explained that voided checks were discarded. They also explained that it was common to allow customers to take checks home with them for the customers' records. In particular, we note that petitioners' practice of permitting customers to leave with the restaurant's only original records of sales completely destroyed the reliability of guest records. Accordingly, we hold that the Administrative Law Judge properly determined that it was impossible for the Division to independently verify the restaurant's taxable sales and receipts from the guest check records, given petitioners' practices.

We also hold that the Administrative Law Judge properly admitted the audit work papers, including the spreadsheet, into evidence. The rules of evidence do not apply at hearings before the Division of Tax Appeals (20 NYCRR 3000.10[5][d][1]), and even hearsay evidence is admissible. It is the role of the Administrative Law Judge to determine the relevance and credibility of evidence and provide the proper weight in making his or her determination (*see Matter of Gray v. Adduci*, 73 NY2d 741 [1988]; *Matter of Flanagan v. New York State Tax Commn.*, 154 AD2d 758 [1989]). Here, the Division's witness testified to facts in the audit file, including the keying of guest checks that resulted in the spreadsheet. Petitioners present the same arguments here as below. The Administrative Law Judge weighed these arguments and found the spreadsheet and testimony to be credible and relevant. We defer to the Administrative Law Judge, as petitioners have not pointed to any facts sufficient to override our deference (*see Matter of Spallina*, Tax Appeals Tribunal, February 27, 1992; *see also Matter of Burke*, Tax

Appeals Tribunal, June 2, 1994).

The Administrative Law Judge properly rejected petitioners' objections to the use of the one-day observation test. The Courts have repeatedly sustained the extrapolation of such tests to multi-year audit periods (*see e.g. Matter of Del's Mini Deli v. Commissioner of Taxation and Fin.*, 205 AD2d 989 [1994]; *Matter of Lombard v. Commissioner of Taxation and Fin.*, 197 AD2d 799 [1993]; *Matter of Sarantopoulos v. Tax Appeals Trib*, 186 AD2d 878 [1992]). Further, the Administrative Law Judge properly rejected petitioners' proposed audit because it relies upon the same insufficient guest checks that prompted the use of an indirect audit methodology. Given the fact that petitioners failed to maintain the requisite books and records necessary to conduct an audit, the methodology used here was reasonable under the circumstances and exactness was not required (*see e.g. Matter of Markowitz v. State Tax Commn., supra*; *Matter of Meskouris Bros. v. Chu*, 139 AD2d 813 [1988]; *see also W.T. Grant Co., supra*). Accordingly, we find that the Administrative Law Judge properly determined that petitioners failed to meet their burden of showing that both the audit method and the tax assessed were erroneous.

We also hold that the Administrative Law Judge properly upheld the penalty asserted because petitioners failed to provide reasonable cause for the non-payment of sales tax due (Tax Law § 1145[a][1][iii], [vi]; 20 NYCRR 2392.1[a][1]; *see Matter of MCI Telecom. Corp.*, Tax Appeals Tribunal, January 16, 1992; *Matter of Philip Morris*, Tax Appeals Tribunal, April 29, 1993).

We have considered the remaining arguments raised by petitioners and find them either properly resolved by the Administrative Law Judge or unsupported by the record.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions of 2720 Henrietta - Brighton, Inc. and Wang Y. Hwang, as officer, are denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of 2720 Henrietta - Brighton, Inc. and Wang Y. Hwang, as officer, are denied; and
4. The Notices of Determination dated January 17, 2008 and January 18, 2008, are sustained.

DATED: Troy, New York  
May 12, 2011

/s/ James H. Tully, Jr.  
James H. Tully, Jr.  
President

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

/s/ Charles H. Nesbitt  
Charles H. Nesbitt  
Commissioner