

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petition :

of :

**88-02 DELI GROCERY CORPORATION** :

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 September 1, 2004  
through May 31, 2007. :

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DECISION  
DTA Nos. 823291  
and 823292

In the Matter of the Petition :

of :

**SULTAN R. ALI** :

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, 2005  
through May 31, 2007. :

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Petitioners, 88-02 Deli Grocery Corporation and Sultan R. Ali, filed an exception to the determination of the Administrative Law Judge issued on September 22, 2011. Petitioners appeared by the Antonious Law Firm (Jacqueline S. Antonious, Esq., of counsel). The Division of Taxation appeared by Mark Volk, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a letter brief in lieu of a formal brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on March 21, 2012 in New York, New York.

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

following decision.

***ISSUES***

I. Whether the Division of Taxation properly determined additional sales and use taxes due from petitioner 88-02 Deli Grocery Corporation.

II. Whether penalties imposed under Tax Law §§ 1145 (a) (1) (i) and (vi) should be cancelled.

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge, except for finding of fact “27,” which has been modified. The Administrative Law Judge’s findings of fact and the modified finding of fact are set forth below.

During the period in issue, petitioner 88-02 Deli Grocery Corporation (88-02 Deli Grocery) owned and operated a grocery and deli in Ozone Park, New York, making taxable sales of, among other things, beer, soda, cigarettes, sandwiches and coffee, and nontaxable sales of, among other things, food, milk and newspapers. 88-02 Deli Grocery had one cash register.

88-02 Deli Grocery was incorporated on June 9, 2004 and elected to be treated as a federal S corporation effective January 1, 2005. Petitioner Sultan R. Ali at all relevant times was president and 100 percent shareholder of 88-02 Deli Grocery.

During the audit period at issue, consisting of 11 sales tax quarters (a period of two years and 9 months), 88-02 Deli Grocery reported on its sales tax returns total gross sales of \$592,926.00 and total taxable sales of \$189,260.00.

By letter dated August 2, 2007, the Division of Taxation (Division) advised 88-02 Deli Grocery that a sales tax field audit of its books and records for the period September 1, 2004

through May 31, 2007 would commence on August 27, 2007. This audit appointment letter advised 88-02 Deli Grocery that all of its books and records pertaining to its sales and use tax liability for the audit period should be available for review on the audit appointment date. An attached Records Requested List specified a detailed listing of particular records that were to be available for the entire audit period, including sales tax returns; worksheets and canceled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; all exemption documents supporting nontaxable sales; chart of accounts; fixed asset purchase and sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips; cash receipts journal; cash disbursements journal; the corporate book, including minutes, board of directors, and articles of incorporation; depreciation schedules, State Liquor Authority license; lease contracts; utility bills; guest checks; and cash register tapes.

On August 23, 2007, the auditor mailed purchase confirmation letters to suppliers of beer, soda and tobacco. In September 2007, purchase confirmation information from third-party suppliers was received and transcribed by the auditor.

At the request of the corporation's former representative, Gregory Binkiewicz, CPA, the field audit appointment was rescheduled for October 10, 2007. The auditor, Rakesh Patel, met with Mr. Binkiewicz on October 10, 2007 and was provided with 88-02 Deli Grocery's bank statements for the period September 1, 2004 through May 31, 2007, a few purchase invoices and copies of its federal income tax returns for the years 2004 (July 1, 2004 through December 31, 2004), 2005 and 2006. The auditor also received a Responsible Person Questionnaire and a Sales Tax Examination Questionnaire completed by Mr. Binkiewicz.

During the October 10, 2007 audit appointment, Mr. Binkiewicz executed a consent on behalf of the corporation extending the time for determination of sales and use taxes for the period September 1, 2004 through May 31, 2005 until June 20, 2008. Subsequently, on April 22, 2008, Mr. Binkiewicz executed a consent on behalf of the corporation extending the time for determination of sales and use taxes for the period September 1, 2004 through November 30, 2005 until December 20, 2008.

At the October 10, 2007 audit appointment, Mr. Binkiewicz explained that he prepared 88-02 Deli Grocery's sales and use tax returns based upon estimated gross and taxable sales given to him by the corporation. Mr. Binkiewicz also explained that the corporation's payroll was paid by cash and its purchases were paid by cash and check.

During the October 10, 2007 audit appointment, the auditor transcribed bank deposits for the audit period. He also transcribed the addresses of the corporation's suppliers listed on the few purchase invoices provided. At the conclusion of the audit appointment, the auditor provided Mr. Binkiewicz with a handwritten list of records still required to complete the audit. This list included cash register tapes for the audit period; general ledger for the audit period; day book for the audit period; all canceled checks for the audit period; all purchase invoices for the audit period; and any backup for the sales tax returns. The auditor also noted, on the list, that additional information might be requested as the sales tax audit progressed.

Based upon the supplier information obtained during the October 10, 2007 audit appointment, the auditor sent out additional purchase confirmation requests.

On October 23, 2007, the auditor sent a letter to Mr. Binkiewicz that confirmed the next appointment scheduled for November 8, 2007. This letter also advised that all books and records

as requested in the original appointment letter were to be produced at the November 8, 2007 appointment. A copy of the original appointment letter was enclosed.

On November 2, 2007, the auditor conducted a field survey of 88-02 Deli Grocery, which is located on the corner of 88th Street and Liberty Avenue, in Ozone Park. He noted that the grocery store, located on the same corner as the 88th Street - Boyd Avenue subway station, was open 24 hours a day. He observed that there was one cash register, two employees, an 8-door refrigerator for beer located at the back of the store, and an 11-door refrigerator for other beverages located on the side of the store. Taxable items sold included, among other things, cigarettes, candy, sandwiches, coffee, beer, soda, detergent, and phone cards. Nontaxable items sold included, among other things, ice cream, chips, danish, newspapers, and juices.

During the second field appointment conducted on November 8, 2007, Mr. Binkiewicz presented the sales tax returns; day books for the period September 1, 2004 through May 31, 2007; some scattered purchase invoices; bank statements for the period September 1, 2004 through May 31, 2007; the bill of sale; and the bulk sale notice (memo). No cash register tapes were presented during this audit appointment. The auditor transcribed the day books, which listed, by date, daily sales, total weekly gross sales and total weekly taxable sales. However, he was unable to trace any of the summarized transactions through to the sales tax returns or determine whether all of the transactions were entered in the day books because no source documents were presented.

After reviewing the day books and the other records provided by 88-02 Deli Grocery, the auditor informed Mr. Binkiewicz that the records provided were inadequate for the performance of a detailed audit, and that the Division would perform an observation of the business to

determine 88-02 Deli Grocery's sales tax liability. By letter dated January 31, 2008, the auditor confirmed his recent conversation with Mr. Binkiewicz regarding the necessity to perform an observation of his former client's business within the next six weeks.

On February 7, 2008, the Division conducted an observation of 88-02 Deli Grocery's business. The observation was conducted by three Division investigators, who wrote down each sale made between the hours of 7:00 A.M. and 7:00 P.M., when the business closed for the day. Gross sales as observed totaled \$982.54, and taxable sales as observed, including sales tax, totaled \$741.61. After deducting sales tax of \$62.11 from taxable sales as observed, the auditor determined net audited taxable sales of \$679.50. He then divided net audited taxable sales by 12 (the number of hours observed) and computed net audited hourly taxable sales in the amount of \$56.63. Based upon the auditor's determination that 88-02 Deli Grocery was open 24 hours a day, he multiplied \$56.63 by 24 and determined audited daily taxable sales to be \$1,359.00. This amount was multiplied by 90 days in the sales tax quarter, resulting in audited quarterly taxable sales of \$122,310.03. After multiplying audited quarterly taxable sales by 11 (the number of quarters in the audit period), the auditor determined total audited taxable sales to be \$1,345,410.32 for the period September 1, 2004 through May 31, 2007. Then, he subtracted \$189,260.00, total reported taxable sales for the audit period, from \$1,345,410.32, and determined additional taxable sales to be \$1,156,150.32. After applying the appropriate sales tax rate for each quarter, the auditor determined that \$97,615.87 in additional sales tax was due for the period September 1, 2004 through May 31, 2007.

During the audit, the auditor also reviewed 88-02 Deli Grocery's federal income tax return filed for the year 2004 (July 1, 2004 through December 31, 2004) and determined that the

corporation purchased fixed assets in the amount of \$10,000.00 during that year. Because the corporation did not provide any invoice or other documentation showing that tax was paid on its purchase of the fixed assets, the auditor determined \$863.00 in tax due on that purchase.

After combining the additional tax due on fixed assets, \$863.00, with the additional tax due on sales, \$97,615.87, the auditor determined total additional tax due in the amount of \$98,478.87 for the period September 1, 2004 through May 31, 2007.

A memo dated March 5, 2008 from the Division's investigator, John Clerkin, stated that on Monday, March 3, 2008, he observed 88-02 Deli Grocery open at least until 11:05 P.M.

At a field appointment on May 8, 2008, the auditor discussed his audit findings with Mr. Binkiewicz, who objected to the proposed audit adjustment, stating that the business was not open 24 hours a day.

On May 27, 2008, Mr. Binkiewicz advised the auditor that he no longer represented the corporation because it had retained new representation. Subsequently, the auditor received a power of attorney appointing Jacqueline S. Antonious, Esq., as the corporation's representative. On June 3, 2008, the auditor mailed tax due worksheets to Ms. Antonious. Thereafter, at Ms. Antonious's request, the auditor faxed a summary of third-party purchase confirmations to her.

On August 14, 2008, Ms. Antonious faxed a letter with attachments to the auditor. In her letter, Ms. Antonious advised that the store had undergone "some extensive expansion construction in late 2007, where the shelving space almost doubled in capacity." Copies of three receipted invoices from Penn Glass Enterprises Ltd., dated October 18, 2007, November 21, 2007 and December 4, 2007, were attached to the letter. Ms. Antonious also included a copy of the summary of the corporation's purchases of Boar's Head products for 2004 through 2007,

which she received from Parziale Provisions.

On August 26, 2008, Ms. Antonious met with the auditor at the Division's Queens District Office. During that meeting, Ms. Antonious proposed that the auditor use 88-02 Deli Grocery's purchases and a markup analysis to estimate the tax due for the audit period. In support of her proposal, Ms. Antonious provided the auditor with a markup analysis of the corporation's purchases, which estimated that 88-02 Deli Grocery owed \$7,079.16 in additional tax. No backup was provided for Ms. Antonious's computation of tax due. At the conclusion of that meeting, the auditor advised Ms. Antonious that the observation would be used because the books and records provided were inadequate, and a summary of tax, interest and penalty worksheet was given to her.

After modifying the tax due computation and summary of tax due to correct a mathematical error, the auditor, on September 18, 2008, called Ms. Antonious to discuss the corrected computation.<sup>1</sup> During that telephone call, Ms. Antonious advised that she did not have any additional information to submit and that she disagreed with the additional tax due. She also requested to go to the Bureau of Conciliation and Mediation Services.

The Division subsequently issued to 88-02 Deli Grocery a Statement of Proposed Audit Change for Sales and Use Tax dated September 18, 2008, which asserted additional tax due on sales and fixed assets as noted above and thereby asserted a total of \$98,478.89, plus penalty and interest. The proposed penalties were computed pursuant to Tax Law § 1145 (a) (1) (i) and (vi). The auditor sent the statement and supporting tax due computation worksheets to Ms.

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<sup>1</sup> A \$0.02 addition error was made by the auditor when he originally computed the total additional tax due for the audit period.

Antonious.

On September 23, 2008, the auditor received the disagreed Statement of Proposed Audit Change for Sales and Use Tax signed by Ms. Antonious, as well as a letter dated September 22, 2008 from Ms. Antonious. That letter stated the following reasons for disagreement:

1. The assessment is based on an inaccurate calculation of a 24-hour business operation for the entire tax period, where in fact this business is an owner-run operation open on average 12 hours per day.
2. The observation date of 2/07/08 is an inaccurate means to calculate accurate taxable sales during the tax period because the store underwent an expansive construction project in late 2007, which expanded a considerable amount of storage area into the main store room and doubled the shelving area in the store.
3. The assessment fails to take into account the actual taxable purchases found in the comprehensive list of purchase order invoices from the store's suppliers. The letter also requested that the penalties be waived "because as the weight to the evidence will demonstrate, there has not been more than a 25% under-reporting of taxable sales."

The Division issued a Notice of Determination to 88-02 Deli Grocery Corp., dated October 16, 2008, asserting additional sales and use taxes due in the amount of \$98,478.89 for the period September 1, 2004 through May 31, 2007, plus penalty in the amount of \$38,774.41 and interest in the amount of \$45,051.61 for a balance due of \$182,304.91. On December 22, 2008, the Division issued a Notice of Determination to Sultan R. Ali, as an officer or responsible person of 88-02 Deli Grocery Corp., asserting sales and use tax due of \$52,815.06 for the period December 1, 2005 through May 31, 2007, plus penalty of \$20,949.36 and interest of \$19,041.40 for a balance due of \$92,805.82. Each of the statutory notices assessed penalties pursuant to Tax Law §§ 1145 (a) (1) (i) and (vi).

We modify finding of fact "27" of the Administrative Law Judge's determination to read as follows:

At the hearing, the auditor testified that he determined that 88-02 Deli Grocery was open 24 hours a day based upon his November 2, 2007 field survey of the business and Mr. Clerkin's memo regarding his March 3, 2008 observation of the business. However, because the business was never actually observed for an entire 24-hour period and the audit file did not contain any proof supporting the auditor's statement that the business was open 24 hours a day, the Division, at the hearing, adjusted the assessment to reflect additional tax due based upon a 12-hour operation, as follows. The adjustment from a 24-hour operation to a 12-hour operation reduced audited taxable sales from \$1,345,410.32 to \$672,705.16 for the period September 1, 2004 through May 31, 2007. After subtracting \$189,260.00, total reported taxable sales for the audit period, from \$672,705.16, the auditor determined revised additional taxable sales in the amount of \$483,445.16 and revised additional tax due from sales in the amount of \$40,818.15 for the period September 1, 2004 through May 31, 2007. The auditor added \$863.00, the additional tax due on fixed assets, to \$40,818.15 and determined total revised additional tax due in the amount of \$41,681.15 for the period September 1, 2004 through May 31, 2007. The auditor further reduced the revised additional tax due to \$29,925.56 by allowing an additional prepaid cigarette sales tax credit of \$10,097.34 and a tax credit of \$1,658.25 for exempt food stamp sales. As a result, the Division also modified the additional tax asserted against Sultan R. Ali from \$52,815.06 to \$15,672.54.<sup>2</sup>

The additional prepaid cigarette sales tax credit was computed as follows. First, the auditor multiplied 37, the number of packs of cigarettes sold on the day of the observation, by \$0.36, the prepaid sales tax credit per pack, and determined the total daily cigarette sales tax credit to be \$13.32. This amount was multiplied by seven days per week, resulting in a total weekly cigarette sales tax credit of \$93.24. Then, the auditor multiplied \$93.24 by 13 weeks per sales tax quarter, and determined the total quarterly cigarette sales tax credit to be \$1,212.12. After multiplying the total quarterly cigarette sales tax credit by 11 (the number of quarters in the audit period), the auditor determined the total cigarette sales tax credit to be \$13,333.32 for the period September 1, 2004 through May 31, 2007. He then subtracted \$3,236.00, the total reported cigarette sales tax credit for the audit period, from \$13,333.32, and allowed an

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<sup>2</sup> We modify this fact to more accurately reflect the record.

additional cigarette sales tax credit in the amount of \$10,097.32 for the period September 1, 2004 through May 31, 2007.

With respect to the sales tax credit allowed for exempt food stamp sales, on March 13, 2009, Ms. Antonious sent a letter, along with attachments, to the auditor's supervisor, Theodore Bernstein, claiming that 88-02 Deli Grocery was entitled to exempt food stamp sales of \$1,200.00 per month. Since the representative did not provide supporting documentation for the entire audit period, the auditor refused to allow the claimed exempt food stamp sales. However, after discussions with Ms. Antonious and in an effort to be reasonable, the auditor allowed \$600.00 of exempt food stamp sales per month. After multiplying \$600.00 by 33, the number of months in the audit period, the auditor determined exempt food stamp sales to be \$19,800.00. After multiplying \$19,800.00 by a tax rate of 8.375 percent, the auditor allowed a sales tax credit for exempt food stamp sales in the amount of \$1,658.25.

Petitioners submitted the affidavit of Sultan R. Ali, the president and 100 percent shareholder of 88-02 Deli Grocery during the period at issue. In his affidavit, Mr. Ali asserted that the store is usually open 10 to 12 hours a day and that he runs the business by himself, but occasionally, he relies on family members to watch the store in his absence. Mr. Ali's affidavit further asserted that the auditor never requested to review any documents except for purchase invoices and federal tax returns; that the business's cash register was incapable of producing receipts or cash register tapes, but he kept a daily record of total gross and taxable sales; that he objected to the observation being conducted without the presence of his accountant; that there were food stamp sales on the date of the observation that the bank records of the "Efund direct deposit for that day confirms"; that he purchases cigarettes from Sunrise, and the third-party

invoice summaries confirm the number of cartons purchased throughout the audit period; and that he made every effort to keep adequate books and records and to ensure that the proper amount of tax was reported. His affidavit also claimed that in late 2007, the business underwent an expansion, costing about \$13,000.00, that resulted in increased sales. No exhibits were attached to Mr. Ali's affidavit.

Petitioners' sole witness was Nashaat Antonious, an accountant retained by 88-02 Deli Grocery sometime in May 2008. At some point thereafter, Mr. Antonious reviewed the corporation's handwritten sales tax records for the audit period, and after organizing them into "something readable," he prepared a computerized summary of the corporation's gross and taxable sales for the audit period. According to Mr. Antonious, the corporation's day books were not given to him to review. The record includes an 11-page summary of gross and taxable sales for the audit period prepared by Mr. Antonious. The supporting documents used to prepare this summary are not part of the record. A comparison of quarterly sales contained in this summary to those reported on the sales and use tax returns filed by 88-02 Deli Corporation for the audit period indicates that they are identical.

A 17-page printout for "Customer: 235 DELI GROCERY CORP," bearing a print date of July 19, 2010 was submitted into the record. This printout contained information regarding purchases made by that customer from September 1, 2004 through September 29, 2007, including, among other things, the date of each invoice, the invoice number, total due on the invoice, amount paid, date paid, and the number of cigarettes purchased on each invoice. The following totals appear at the bottom of page 17 of the printout: "Invoices: 951, Amt: 608510.71, Credits: 0.00, Cigs: 10439." The name of the entity that prepared this printout, i.e., the seller,

does not appear anywhere in the printout.

According to Mr. Antonious, based on his review of the 17-page printout, petitioner purchased a total of 104,390 packs of cigarettes from Sunrise Candy & Tobacco Corp. (Sunrise) during the period September 1, 2004 through September 29, 2007, and therefore was entitled to a prepaid cigarette sales tax credit in the amount of \$37,580.00 for that period. Mr. Antonious did not review any purchase invoices or other documents that indicated that 88-02 Deli Grocery purchased the cigarettes listed in the 17-page printout.

During the audit, the auditor received purchase confirmation information from nine vendors, including Sunrise. Audit work papers indicate that the nine vendors confirmed purchases by 88-02 Deli Grocery in the total amount of \$537,247.99 during the period September 1, 2004 through May 31, 2007. According to the purchase confirmation information provided to the auditor, monthly sales made by Sunrise to 88-02 Deli Grocery totaled \$345,301.00 for the period September 1, 2004 through April 30, 2007. The purchase confirmation information received from Sunrise did not include the number of packs of cigarettes purchased by 88-02 Deli Grocery during the period September 1, 2004 through April 30, 2007.

The record does not include any purchase invoices from Sunrise for the period September 1, 2004 through May 31, 2007. No purchase invoices reflecting 88-02 Deli Grocery's purchases of cigarettes from any third party are part of the record.

On its federal income tax returns filed for the years 2004 through 2007, 88-02 Deli-Grocery reported inventory purchases in the total amount of \$494,819.00 for those years.

88-02 Deli Grocery's checking account statement for the period January 16, 2008 through February 13, 2008 listed a deposit in the amount of \$42.09 by "Efunds Corp Dly Settle" on

February 7, 2008. According to Mr. Antonious, that Efunds Corp. direct deposit indicated that 88-02 Deli Grocery made exempt food stamp sales of \$42.09 during the observation conducted on February 7, 2008. He then surmised that if that amount was extrapolated over the audit period, the corporation would be entitled to a sales tax credit for exempt food stamp sales of about \$4,000.00. Mr. Antonious did not review any documents that indicated that the Efunds Corp. direct deposit on February 7, 2008 was for exempt food stamp sales made on the date of the observation.

The record includes the ledger sheets handwritten by the investigators during their February 7, 2008 observation of 88-02 Deli Grocery's sales. These ledger sheets contain information concerning the investigators' observation of sales, including the time of the sale, a description of the items sold, the cost of any cigarettes sold, the nontaxable amount of the sale, the taxable amount of the sale, and the total amount of the sale. No payments by food stamps were noted on these handwritten ledger sheets.

At the hearing, the auditor admitted that he did not know how the United States Department of Agriculture (USDA) credits food stamp purchases to retail food stores approved to participate in the federal food stamp program.

The record includes 88-02 Deli Grocery's checking account statements for the period August 12, 2006 through April 12, 2007. Numerous direct deposits made by Efunds Corp. were listed on each of these checking account statements.

The record does not include any receipts, books or records that show what items were purchased with food stamps (taxable and nontaxable) either during the audit period or on the date of the observation, i.e., February 7, 2008.

The record includes an invoice dated August 17, 2004 issued to “88-02 Grocery Corp.” by Zaid Repair and Maintenance Services, of Brooklyn, New York. This invoice reflects a total charge of \$10,000.00 to “repair and fix wall, floor and ceiling [sic],” a deposit of \$2,500.00 and a balance due of \$7,500.00. “Paid” is handwritten at the bottom of this invoice. The record does not include any canceled checks, bank statements or receipts verifying payment of such invoice. There is also no detailed list of the date, location and type of work performed, and the materials used in such work.

As part of its federal income tax return filed for the year 2004, 88-02 Deli Grocery completed Schedule L, Balance Sheets per Books, on which it reported no buildings and other depreciable assets at the beginning of the tax year, and buildings and other depreciable assets of \$10,000.00 less accumulated depreciation of \$1,000.00, or \$9,000.00, at the end of the tax year. A depreciation deduction in the amount of \$1,000.00 was claimed by the corporation on its 2004 federal income tax return. No supporting depreciation worksheet was attached to this return.

On each of its federal income tax returns filed for the years 2004, 2005, 2006 and 2007, 88-02 Deli Grocery claimed a deduction for rents paid. The record does not include a copy of the lease for the business premises.

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

The Administrative Law Judge observed the standards for reviewing a sales tax audit based on an external audit methodology. In reviewing the record, the Administrative Law Judge found that the Division made proper written and oral records requests and properly determined that petitioners failed to produce books and records sufficient to conduct a full audit.

The Administrative Law Judge noted that, at the hearing, the Division made certain

adjustments to the audit of petitioners, including a substantial reduction in the operating hours of the store and accounting for prepaid cigarette tax, as well as exempt food stamps sales. In light of the foregoing, the Administrative Law Judge concluded that the Division's assessment, as modified, was reasonably calculated to determine the amount of tax due. The Administrative Law Judge found that further modifications were not sufficiently substantiated by the record.

Accordingly, the Administrative Law Judge sustained the Notices of Determination issued to petitioners as modified.

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

On exception, petitioners initially argue that the audit methodology was unreasonable because they allege that the Division failed to account for purported exempt food stamp sales. Petitioners reference a bank deposit made on February 7, 2008 to argue that exempt food stamp sales were made on the day of the observation test. Petitioners argue that the Division committed a fatal error because it failed to record such sales. As such, petitioners argue that the assessment should be cancelled.

In the alternative, petitioners argue that the record supports further downward modifications to the assessment. Petitioners contend that the record supports additional cigarette tax credits for the audit period. Petitioners also argue that the assessment should be modified to account for exempt food stamp sales. As such, petitioners request that the Tribunal modify the subject Notices.

The Division argues that the Administrative Law Judge properly resolved the issues in this matter. Initially, the Division notes that petitioners' position is unsupported by the record because it does not distinguish between taxable and tax exempt sales. The Division further

argues that petitioners' argument must fail because it seems to impose the cost of imprecision in the audit methodology upon the Division, which controverts both statute and jurisprudence.

The Division argues that the record does not support further modification to the assessment. The Division notes that, at the hearing, it consented to several modifications in order to make the assessment more accurate. With regard to petitioners' request for an additional modification for prepaid cigarette tax, the Division notes that a taxpayer would be entitled to a credit for prepaid cigarette tax based on establishing certain conditions (e.g. that the packs of cigarettes were sold, that the taxpayer consumed the cigarettes, or that the cigarettes were no longer in consumable condition). The Division argues that the record is insufficient to meet any of these circumstances. Regarding a modification for food stamps, the Division argues that nothing in the record would substantiate an additional modification. As such, the Division argues that the determination of the Administrative Law Judge should be affirmed.

### ***OPINION***

This Tribunal has well-established standards for reviewing sales tax audits. As summarized in *Matter of AGDN, Inc.* (Tax Appeals Tribunal, February 6, 1997):

“[A] vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained ‘shall include a true copy of each sales slip, invoice, receipt, statement or memorandum’ (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, ‘the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .’ (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43).

When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (*Matter of Grant*

*Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869); exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*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).”

Having reviewed the appropriate standards, we now turn the instant audit.

The record shows that the Division made proper records requests to the corporate petitioner, both written and orally. Petitioners responded with the documents in the record, which include various summaries from the audit period, bank statements, purchase invoices, and the corporate petitioner’s Forms 1120 from 2005, 2006, and 2007. The record does not contain a single sales slip, invoice, receipt or statement that would enable an individual to trace a sale to any of the summaries or other documents (Tax Law § 1135; 20 NYCRR 533.2 [b] [1]). Given the foregoing, we find that the corporate petitioner failed to maintain proper sales tax records. On exception, petitioners do not meritoriously challenge this conclusion. Accordingly, we find that the Administrative Law Judge properly determined that the Division was entitled to estimate petitioners’ tax liability utilizing external indicies.

The Tax Law provides the Division with the discretionary authority to use any method to reasonably calculate the amount of tax due (*Matter of Surface Line Operators Fraternal Org. v Tully*, 85 AD2d 858 [1981]). “[W]here the taxpayer’s own failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required” (*Matter of Meyer v State Tax Commn.*, 61 AD2d 223, 228 [1978], *lv denied* 44 NY2d 645 [1978]). In order to successfully challenge an assessment based upon an estimated audit methodology,

“the taxpayer has the burden of overcoming a deficiency assessment by clear and convincing evidence showing that both the method used to arrive at the assessment and the assessment itself are erroneous” (*Matter of Giuliano v Chu*, 135 AD2d 893, 895 [1987]; Tax Law § 689).

We also note that a presumption of correctness attaches to the statutory notice (*Matter of Tivolacci v State Tax Commn.*, 77 AD2d 759 [1980]). However, this Tribunal may cancel an assessment where a taxpayer clearly and convincingly establishes a fatal error in the audit method, which lacks an explanation (*see e.g. Matter of 33 Virginia Place*, Tax Appeals Tribunal, December 23, 2009). Where a taxpayer introduces clear and convincing evidence of a non-fatal error, this Tribunal has held that modification is the proper remedy (*see e.g. Matter of Berstein-On-Essex St.*, Tax Appeals Tribunal, December 3, 1992). Bearing these standards in mind, we now turn to the instant matter.

The Division estimated petitioners' liability utilizing a one-day observation test. The Courts have held it reasonable for the Division to extrapolate the results of a one-day observation test across a multi-year period (*see e.g. Matter of Del's Mini Deli v Commissioner of Taxation & Fin.*, 205 AD2d 989 [1994]). The Division issued an assessment based on an observation test conducted on February 7, 2008. At the hearing, the Division made certain modifications to the assessment, including factoring in that the store was open only for 12 hours per day, adding in tax on fixed assets, and providing credits for prepaid cigarette tax and food stamps. We conclude that, in light of these modifications, the assessment is not unreasonable on its face.

Turning to petitioners' challenges, we find no merit in the argument that the audit method was fatally flawed due to a failure to account for purported exempt food stamp sales. Petitioners' argument relies exclusively on a bank statement. This document shows that “Efunds” made a deposit into the corporate petitioner's bank account on the day of the observation test. This

document is neither a record of food stamp sales (Tax Law § 1135; 20 NYCRR 533.2 [d] [7]), nor does it contain information that would link the February 7, 2008 deposit to any individual sale on that date, much less the taxability of such a sale. The record lacks clear and convincing evidence sufficient to rebut the presumption of correctness (*c.f.*, ***Matter of 33 Virginia Place***, Tax Appeals Tribunal, December 23, 2009). Accordingly, we reject petitioners' argument that the audit methodology was unreasonable.

We also reject petitioners' arguments for further modifications to the assessment based on prepaid cigarette tax. Initially, we disagree with the Administrative Law Judge's determination that the summary did not clearly identify the corporate petitioner as the purchaser. In our view, the document clearly identifies the corporate petitioner as the purchaser of quantities of cigarette cartons. However, this evidence alone is insufficient to establish entitlement to any further credit. The summary only establishes that the corporate petitioner purchased quantities of cigarette cartons. It does not clearly or convincingly establish sales, use, or any other condition that would entitle petitioners to additional cigarette tax credit. In reviewing the record, we found no receipt, cash register tapes, or any other evidence that would link the purchases from the supplier to even a single sale of cigarettes during the audit period. Absent clear and convincing records of sales, we find that petitioners are not entitled to an additional adjustment (*see e.g.* ***Matter of Nicholls v State Tax Commn.***, 101 AD2d 950 [1984]).

Penalties may be cancelled if it is shown that the failure to timely file and pay was due to reasonable cause and not willful neglect. In establishing reasonable cause, the taxpayer faces an "onerous task" (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). In reviewing the record, we conclude that petitioners did not establish that the corporate petitioner's

failure to pay tax was due to reasonable cause and not due to willful neglect.

Additionally, petitioners did not produce clear and convincing evidence showing that tax was not due on its improvements or establish reasonable cause for the abatement of penalties.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 88-02 Deli Grocery Corporation and Sultan R. Ali is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of 88-02 Deli Grocery Corporation is granted to the extent that the additional tax asserted in the Notice of Determination, issued October 16, 2008, is recomputed to \$29,925.56, but otherwise is denied; the petition of Sultan R. Ali is granted to the extent that the additional tax asserted in the Notice of Determination, issued December 22, 2008, is recomputed to \$15,672.54, but otherwise is denied; and
4. The Notices of Determination issued on October 16, 2008 and December 22, 2008, as modified in paragraph "3" above, are sustained.

DATED: Albany, NY  
September 13, 2012

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

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