

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
CAFE EUROPA, INC. : DETERMINATION  
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, 1980 :  
through May 31, 1984.

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Petitioner, Cafe Europa, Inc., 347 East 54th Street, New York, New York 10022, filed a petition 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, 1980 through May 31, 1984 (File No. 802239).

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 23, 1988 at 10:25 A.M. Petitioner appeared by Howard Tanz, CPA. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUES

I. Whether the books and records of a restaurant are adequate under the requirements of Tax Law § 1135(a)(1) and the Division of Taxation's regulations (20 NYCRR 533.2[a], [b] and [c]) so as to preclude an audit based on a test period (under Tax Law § 1138[a][1]) where, as agreed at the hearing, cash register tapes do not exist, some purchase invoices may be missing and guest checks, bearing imprinted numbers, used on any single day do not bear a consecutive sequence of numbers so that the gaps in the sequence may indicate missing checks.

II. Whether a penalty under Tax Law § 1145(a)(1) for failure to pay the tax due may be remitted as due to reasonable cause and not to willful neglect.

FINDINGS OF FACT

1. (a) On March 20, 1985, two notices of determination and demands for payment of sales and use taxes due were issued against petitioner, Cafe Europa, Inc. One was for the period September 1, 1980 through February 29, 1984 and is in the amount of \$71,780.26, plus a penalty of \$17,113.11 and interest of \$27,435.74, for a total of \$116,329.11. The other was for the

period March 1, 1984 through May 31, 1984 and is in the amount of \$5,090.66, plus penalty of \$661.79 and interest of \$477.94, for a total of \$6,230.39. (Valid consents had been signed on September 28, 1983, April 24, 1984 and November 5, 1984, extending the period of limitation for assessment to March 20, 1985.)

(b) The penalty was imposed under Tax Law § 1145(a)(1). This was due, according to the auditor, because petitioner failed to provide purchase invoices and cash register tapes and did not have complete records for the test period.

2. Cafe Europa, Inc. operates a restaurant at 347 East 54th Street, New York City. It was open for lunch and dinner six days a week. During the audit period one owner worked in the dining room. The other owner, currently the sole owner, worked as a chef. The restaurant generally had three chefs and three or four waiters on duty. It had no cash register.

3. (a) Petitioner had a cash receipts journal and a general ledger, and kept guest checks and purchase invoices.

(b) The purchase invoices were available at the hearing. No particular invoices were specified by the Division of Taxation as being missing.

(c) The guest checks were kept separately by days. They were kept in the order in which they were presented to the cashier and not according to their imprinted number. Even when put in sequence by their imprinted number, there were gaps in the sequence of numbers caused by missing checks. The usual cause of this was a waiter with a later numbered pad of checks using all of his checks and a waiter with an earlier numbered pad not doing so and carrying the checks over to the next day or the next time he worked.

(d) Petitioner had no cash register tapes because it did not have a cash register.

4. For the purpose of determining if petitioner's books and records were adequate, a test of guest checks was made for two separate days, August 10, 1982 and August 18, 1982. For August 10, 56 checks were found. These represented check numbers 39898 through 39903, 39905, 39909, 39913 through 39955, 39957, 39958, 39960 and 39961. Between the first and last numbers found, nine numbers were not accounted for. For August 18, 48 checks were found. These represented check numbers 39625 through 39636, 39639 through 39671 and 39697 through 39699. Between the first and last numbers found, 27 numbers were not available (25 of these numbers were in a single block). On this basis, it was determined that the books and records of petitioner were inadequate. On August 10, the net sales recorded were \$2,029.80, sales tax collected was \$167.77 and gross sales were \$2,197.04. On August 18, the net sales were \$1,900.90, sales tax collected

was \$156.50 and gross sales were \$2,056.40.<sup>1</sup>

5. For the purpose of computing additional taxable sales, an observation test was made on two separate days, Wednesday, October 26, 1983 and Friday, February 17, 1984. A tax examiner stood at the exit on each day and inspected the guest checks. He tallied amounts for the net sale, the sales tax charged and the bar total as shown separately on the bill. These were examined as each customer left and not in numerical order. On October 26, 1983, there was a total of 44 checks. These represented check numbers 00616 through 00618, 00640, 00641, 00687 through 00705, 00721 through 00736 and 00738 through 00741. (Check numbers for 83 checks were missing.) On February 17, 1984, there was a total of 39 checks. These represented check numbers 37695 through 37712, 37736 through 37740, 37742 through 37744 and 37746 through 37758. (Check numbers for 26 checks were missing.) On October 26, the net sales were \$2,221.60, tax collected was \$182.96 and total sales were \$2,404.56. On February 17, the net sales were \$1,973.80, sales tax collected was \$163.71 and total sales were \$2,137.51. From these figures the auditor averaged out per-day figures. He then multiplied these totals by 6 to compute per-week figures, then by 52 to compute yearly figures and then divided by 4 to compute quarterly figures. Since 15 quarters were being audited, he multiplied the quarterly totals by 15 to arrive at totals for the audit period. The total sales thus computed exceeded the reported sales by about 62 percent.

6. A purchase markup audit was performed by the auditor. He apportioned to each item on the menu the cost of all ingredients including vegetables, spices and herbs. Purchase invoices were apparently available for these items. As a result of the markup audit, the auditor arrived at an additional tax due. Some of the costs arrived at, as petitioner points out and the Audit Division concedes, are highly unrealistic. The auditor abandoned this audit, he states, because of the absence of purchase invoices. The auditor did not attempt an audit based on the purchase of only major items such as meat and fish. The Division of Taxation does not now argue for the validity of the purchase markup audit.

7. Petitioner, for the purpose of corroborating its own books and records, performed an audit of its credit card sales. Petitioner added up the deposits in its bank accounts which originated in credit card sales. Petitioner then assumed that they comprised 86 percent of total sales and that they included tips of 20 percent and tax of 8.25 percent. A figure for taxable sales was arrived at which was higher than reported taxable sales

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<sup>1</sup>Gross sales do not equal the total of net sales plus sales tax collected due to numerous addition errors made by the auditor.

by less than 5 percent. (The figure of 86 percent had been found by the auditor to be the ratio of credit card sales to total sales during an observation test made by the auditor.)

#### CONCLUSIONS OF LAW

A. The audit underlying the determinations under review must be rejected. It is, of course, a test period audit. The resort to an audit based on a test period to determine the sales tax for an entire audit period must be founded upon an insufficiency of recordkeeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commission, 65 AD2d 44, 46). The records in this case must be found to be adequate. Tax Law § 1135(a)(1) requires that "[e]very person required to collect tax shall keep records of every sale...and of the tax payable thereon" which shall be "in such form" as regulations shall require. Those regulations (20 NYCRR 533.2) require the retention of guest checks (20 NYCRR 533.2[a][4]; [b][1][ii]), cash register tapes (20 NYCRR 533.2[b][1][iii]) and, for use tax purposes, purchase records (20 NYCRR 533.2[c]). The provision governing the form of records requires sales documents to be dated (20 NYCRR 533.2[f]). The allegation of the Division of Taxation that cash register tapes are missing is misleading since such tapes would not be required where, as here, petitioner has no cash register. The alleged absence of purchase records must also be rejected. No particular purchase records were specified as missing and a purchase markup audit was actually performed although not used. At any rate, purchase records appear to be required only for use tax purposes. The alleged absence of guest checks must also be rejected. While the Department's regulations contain references to sales documents and their proper form, they require only that such documents be dated. There is no requirement that guest checks be numbered and used in sequence. Petitioner's explanation, that any guest checks missing on one day would ordinarily turn up in succeeding days, is credible. This could have been verified by the auditor by checking the guest checks for those other days. The auditor made no attempt to do that. Furthermore, the auditor made no attempt to analyze the guest checks of August 1982 which he had in his possession. The auditor just did not make a sufficient examination to evaluate the sufficiency of the records (see\_\_\_ Matter of King Crab, Inc. v. Chu, 134 AD2d 51).

B. In view of Conclusion of Law "A", Issue II is rendered moot.

C. The petition of Cafe Europa, Inc. is granted and the notices of determination and demands for payment of sales and use taxes due issued March 25, 1985 are cancelled.

DATED: Albany, New York

August 11, 1988

Wright

/s/ Nigel G.

ADMINISTRATIVE LAW JUDGE