STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BITABLE ON BROADWAY, 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 March 1, 1984 through February 28, 1987.	:	

Petitioner, Bitable on Broadway, Inc., 647 Broadway, New York, New York 10012, 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 March 1, 1984 through February 28, 1987 (File No. 806708).

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 21, 1990 at 1:15 P.M. Petitioner appeared by Gerald B. Tepper, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Peter J. Martinelli, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional sales and use taxes due from petitioner, Bitable on Broadway, Inc., for the period at issue.

II. Whether petitioner timely filed a petition for a conciliation conference with respect to two notices of determination and demands for payment of sales and use taxes due issued by the Division of Taxation on October 28, 1988.

FINDINGS OF FACT

Pursuant to a field audit of Bitable on Broadway, Inc. ("petitioner") which commenced in February 1987, the Division of Taxation, on June 20, 1988, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due (Notice No. S880620108M) to petitioner in the amount of $19,476.32, plus penalty and interest, for a total amount due of $31,368.01 for

the period March 1, 1984 through February 28, 1987.

On October 28, 1988, the Division issued two additional notices of determination and demands for payment of sales and use taxes due to petitioner. One such notice of determination (Notice No. S881028078M) was an additional assessment for the first and last quarters of the period at issue (periods ending May 31, 1984 and February 28, 1987) in the amount of $4,044.92, plus penalty and interest, for a total amount due of $6,693.67. The other notice of determination (Notice No. S881028080M) assessed omnibus penalty pursuant to Tax Law § 1145 for the period December 1, 1986 through February 28, 1987 in the amount of $468.06.

Previously, petitioner, by its representative, Gerald B. Tepper, C.P.A., executed consents extending the period of limitation for assessment of sales and use taxes as follows:

Date Executed	Period Extended	Date for Assessment
7-2-87	3-1-84 through 5-31-84	9-20-87
9-3-87	3-1-84 through 8-31-84	12-20-87
12-16-87	3-1-84 through 11-30-84	3-20-88
3-18-88	3-1-84 through 8-31-84	6-20-88

The initial consent was superfluous since no return was filed for that quarter. While the period of limitation for assessment of the sales tax quarter September 1, 1984 through November 30, 1984 was not extended beyond March 20, 1988 (the last consent does not include such quarter), such affirmative defense was not raised by petitioner and will not, therefore, be addressed herein.

On March 10, 1989, a Conciliation Order (CMS No. 88558) was issued by the Bureau of Conciliation and Mediation Services ("BCMS") which sustained the notice of determination issued to petitioner on June 20, 1988.

In its petition seeking a conciliation conference with respect to the two notices of determination issued on October 28, 1988, petitioner included in such petition the initial notice of determination as well as the two subsequent notices. The petition was found not to have been timely filed and a Conciliation Order (CMS No. 93970) was issued on March 24, 1989 which denied the request for a conciliation conference for all three assessments.

At the hearing, the Division of Taxation conceded that a petition was timely filed with

respect to the assessment issued June 20, 1988 (Notice No. S880620108M), but contends that the same was not true for the other assessments.

With respect to the notices of determination issued to petitioner on October 28, 1988, the Conciliation Order (CMS No. 93970) held that the request for a conciliation conference was late filed since the request was not received until February 21, 1989, or in excess of 90 days. Petitioner presented no evidence which would contradict the findings of the Conciliation Order. It must also be noted that the Division of Taxation offered no proof regarding the mailing of these notices of determination.

For the periods at issue, petitioner operated a bar and restaurant business at 647 Broadway in New York City. On February 27, 1987, the auditor sent an appointment letter advising petitioner that an audit of its business would be conducted for the period March 1, 1984 through November 30, 1986. This letter requested that the following books and records be made available: journals; ledgers; sales invoices; purchase invoices; cash register tapes; exemption certificates; all sales tax records; Federal returns for 1985 and 1986; sales and purchase journals for the audit period; expense bills, nontaxable sales and purchase invoices for the months of September, October and November 1986; and all fixed asset bills. The auditor stated that when a decision was made to extend the audit period for an additional quarter (December 1, 1986 through February 28, 1987), an oral request for books and records for this quarter was made to petitioner's representative, Gerald B. Tepper, C.P.A. Mr. Tepper has not denied that such request for records was made.

With the exception of guest checks and register tapes, the auditor was provided with the records requested. The auditor maintains that Mr. Tepper informed him that guest checks and register tapes were not maintained and/or were not available for the entire audit period.

Sales and purchases per records were found to be in substantial agreement with amounts reported on Federal income tax returns. The auditor determined that petitioner's sales tax returns were estimated and, with the exception of one quarter, did not reconcile with its books and records.

The auditor examined the purchase records for the three-month period requested. In addition, confirmation letters were sent to petitioner's suppliers. Some discrepancies were discovered (the auditor found discrepancies which totalled approximately $12,500.00).

The auditor stated that he intended to perform a markup test, but was unable to do so because of large discrepancies between petitioner's purchase records and the responses from the confirmation letters. He also stated that a markup test could not be performed because selling prices could not be determined with any degree of certainty. It must be noted herein that the auditor visited the premises on two occasions (April 7 and July 1, 1987) at which times drinks were purchased (on the second visit, the auditor was accompanied by his supervisor who also purchased a drink and inquired about the price of certain other drinks) and a menu setting forth food prices was obtained. A markup test was also abandoned because petitioner's representative disputed the selling prices obtained by the auditor during his two visits to the premises.

Petitioner made available its guest checks for only one of the sales tax quarters at issue (September 1 through November 30, 1986). The auditor examined the guest checks only for a two-day period in order to determine whether or not petitioner was collecting tax at the proper rate. The auditor did not examine the remaining guest checks provided for this quarter.

Petitioner contends that the corresponding cash register tapes were also made available to the auditor for this quarter. The auditor disputes petitioner's contention, although he admits that he did not examine the guest checks made available. The auditor stated that he did not need to examine the guest checks since petitioner did not have them for the entire audit period.

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.

Petitioner's rental expenses were obtained from its records. These rental expenses were divided by the rent factor (7.1 percent) to arrive at adjusted taxable sales of $1,084,342.69 for the audit period. Petitioner was given credit for taxable sales reported ($848,281.00). The balance ($236,061.69) represented additional taxable sales. Additional tax due, at 8.25 percent, was found to be $19,476.32, the amount of the assessment at issue herein.

As indicated in Finding of Fact "3", supra, two additional notices of determination were issued to petitioner on October 28, 1988. One notice of determination (Notice No. S881028080M) assessed omnibus penalty for the last quarter at issue. The other notice of determination (Notice No. S881028078M) assessed additional tax for the first and last quarters of the audit period. Additional tax was assessed for these quarters due to the fact that petitioner was initially given credit for tax shown to be due (and presumed by the Division to have been paid) on its returns when, in fact, the Division's own records indicated that lesser amounts had been paid for these quarters. With respect to the last quarter, the auditor was shown an amended return which the Division's records subsequently revealed had not been filed.

CONCLUSIONS OF LAW

A. Tax Law § 1138(a)(1) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices. The resort to external indices is predicated upon a finding of insufficiency in the taxpayer's record keeping such that verification of sales is a virtual impossibility (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44). In such circumstances, the Division of Taxation must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948), and the burden is on petitioner to establish by clear and convincing evidence that both the method used to

arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943).

To determine the adequacy of a taxpayer's records, the Division of Taxation must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, lv denied 71 NY2d 806; Matter of King Crab Restaurant v. State Tax Commn., 134 AD2d 51). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., supra; Matter of Ronnie's Suburban Inn, Inc., Tax Appeals Tribunal, May 11, 1989).

The auditor properly requested petitioner's books and records for the period at issue herein (see, Finding of Fact "5"). Petitioner produced source documents, i.e., guest checks for only one quarter (September 1 through November 30, 1986). Petitioner contends that the corresponding cash register tapes for this quarter were also presented although the auditor disputes this contention. Nevertheless, it is clear that since petitioner did not produce such records for the entire audit period, the Division's resort to an audit based upon the use of external indices was proper. What must then be considered is whether or not the audit method selected by the Division of Taxation was one which was reasonably calculated to reflect tax due.

B. Tax Law § 1138(a)(1) provides, in part, as follows:

> "If a return required to be filed 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 of taxation and finance 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." (Emphasis added.)

Estimating tax on the basis of rent paid may, therefore, be an acceptable audit method. However, this method, along with all other audit methods which fall under the category of external indices, must be reasonably calculated to reflect tax due (Matter of Grecian Square v.

State Tax Commn., supra). In order to determine whether or not a particular method was reasonable, such method must be carefully considered in light of the particular facts presented such as the type of business under audit, records made available to the auditor, etc.

In the present matter, petitioner's tax liability was determined through the utilization of a rent factor obtained from the National Restaurant Association's Restaurant Industry Operations Report for 1987. This report indicates that it was prepared in cooperation with Laventhol & Horwath, Certified Public Accountants. As indicated in Finding of Fact "8", supra, the rent factor for the upper quartile of the northeast region was selected per the instructions of the auditor's group chief. 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.

The auditor stated that, as far as he knew, the ratios and percentages were determined based upon information received from restaurants in the New York City metropolitan area. Nothing was presented herein which would substantiate the auditor's statement. Petitioner contends that the National Restaurant Association report does not take into consideration the type, size or location of a particular restaurant and that the Division of Taxation cannot employ this or other similar reports or surveys without fully understanding how the information was compiled or how such information can, if at all, be correlated to a specific business. I must agree with petitioner's contentions.

In Matter of A & J Gifts Shop v. Chu (145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603), the Appellate Division, Third Department, in reviewing an assessment of sales and use taxes, determined through the use of a rent factor against a small, family-owned partnership which operated a flea market, upheld the propriety of the audit method employed stating 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."

There has been no showing in the present matter that there was any attempt made by the Division of Taxation to adjust the results obtained from the utilization of the rent factor to the particular type, size or location of petitioner's restaurant. Moreover, it appears that no such adjustment could have been made, even if found to have been warranted, due to a lack of familiarity with the origin or the methodology of the report from which the rent factor was derived.

It should also be noted that, while petitioner did not have guest checks and cash register tapes for the entire audit period, such records did exist for a portion thereof. In addition, purchase invoices, a cash disbursements journal, a cash receipts journal, Federal income tax returns and other books and records were made available. This was not a situation where the taxpayer was no longer in business or where no books and records existed. A markup test was undertaken but was abandoned due to discrepancies uncovered through responses from petitioner's suppliers to the verification letters sent by the auditor and also because the auditor felt that selling prices could not be determined with any degree of certainty. Whether a markup test could have been adequately performed is not totally clear. It does seem, however, that based upon the fact that petitioner was still in operation at the time of the audit and that a substantial amount of books and records were provided by petitioner, an audit method could have been selected which properly took into account the nature, the size, the location, etc. of petitioner's business. This is not to imply that one external index is preferable to another, but rather that, in selecting an audit method to comply with the requirement that such method be reasonably calculated to reflect tax due, the totality of the facts and circumstances must be considered. Absent a showing of the reliability of a particular statistical study or report and the relevance of such study or report to a particular taxpayer under audit, its utilization cannot be found to be reasonable and, as a result thereof, an assessment resulting therefrom must be

cancelled.

C. With regard to the issue of the timely filing of a petition in response to the notices of determination issued to petitioner on October 28, 1988, such issue is, by virtue of Conclusion of Law "B", rendered moot. One such notice of determination (Notice No. S881028080M) assessed omnibus penalty for the period December 1, 1986 through February 28, 1987. Since the omnibus penalty is assessed for omission of an amount which is in excess of 25 percent of the amount of tax required to be shown on the sales and use tax return and since it has heretofore been determined that such was not the case herein, this assessment must also be cancelled. The remaining notice of determination (Notice No. S881028078M) assessed additional tax for the first and last quarters of the audit period due to the fact that petitioner received credit against the assessment issued on June 28, 1988 for amounts greater than actually paid for such quarters. Because the initial assessment is cancelled, this assessment must also be cancelled.

D. The petition of Bitable on Broadway, Inc. is granted and the notices of determination and demands for payment of sales and use taxes due issued to said petitioner on June 20, 1988 and on October 28, 1988 are hereby cancelled.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE