

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
S & K SMOKE SHOP, INC. AND	:	DETERMINATION
HARESH KHIANI AND	:	
BARBHAJ SAVALIA, AS OFFICERS	:	
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 November 1, 1983	:	
through February 28, 1987.	:	

Petitioners, S & K Smoke Shop, Inc. and Haresh Khiani and Barbhai Savalia, as officers, 120 West 34th Street, New York, New York 10001, 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 November 1, 1983 through February 28, 1987 (File No. 806993).

A hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 9, 1990 at 9:15 A.M., with all briefs to be submitted by June 20, 1990. Petitioners appeared by Haresh Khiani, President of S & K Smoke Shop, Inc. The Division of Taxation appeared by William F. Collins, Esq. (Angelo A. Scopellito, Esq., of counsel).

ISSUE

Whether two observation tests properly determined sales and use taxes due from petitioner S & K Smoke Shop, Inc.

FINDINGS OF FACT

Petitioner S & K Smoke Shop, Inc. ("the corporation") operates a concession stand in the Woolworth store at 120 West 34th Street, New York, New York. It sells cigarettes and other tobacco products, tobaccoaccessories and magazines. It also operates as a New York State Lottery vendor.

Haresh Khiani is president of the corporation and Barbhai Savalia is secretary. Each

owns one-half of the issued and outstanding stock.

This matter was selected for audit on the basis of the BMF¹ audit program which compares gross receipts reported by taxpayers on their Federal income tax returns with gross sales reported on their sales tax returns. It was determined that the corporation did not report gross sales on its sales tax returns, but reported only taxable sales and tax due. A field audit of the business was commenced by the New York District Office on June 3, 1986. The audit activities and findings were as follows:

(a) The auditor determined that the corporation's records were inadequate, as no invoices or cash register tapes were produced. The corporation did not use a cash register, but instead used boxes for cash receipts and change. The cash receipts book was disregarded, since it showed receipts for five days per week, while the auditor found that the business was open seven days.

(b) An observation test was performed on Tuesday, August 26, 1986, between 10:00 A.M. and 5:45 P.M. It showed \$752.05 in total sales (excluding lottery sales) of which \$346.61 were taxable and \$405.54 were nontaxable.² This resulted in total sales of \$94.01 per hour,

which figure was multiplied by the number of hours the Woolworth store was open per week (61) resulting in audited weekly gross sales of \$5,734.61.

(c) The audited weekly gross sales were applied over the audit period of three years and four months for total gross sales of \$993,999.00. This figure was multiplied by the taxable percentage of 46% resulting in audited taxable sales of \$457,240.00. As reported taxable sales were \$72,968.00, the additional taxable sales were \$384,272.00, indicating an error percentage of 526.6%. Application of the error percentage to the additional taxable sales resulted in

¹Business Master File

²There would appear to be an error of \$.10 in the latter 2 figures, which are found on page 21 of the transcript of hearing. The taxable and nontaxable sales shown in the worksheets in evidence are rounded to even dollar amounts.

additional tax due of \$31,702.44.³

(d) The corporation's officers executed a series of four consents extending the period of limitation for assessment of sales and use taxes for the period September 1, 1983 through November 30, 1984 to December 20, 1987.

On December 20, 1987, the Division of Taxation issued the following notices of determination and demands for payment of sales and use taxes due:

(a) To S & K Smoke Shop, Inc.:

(i) Period November 1, 1983 through February 28, 1987, \$31,700.47 tax, \$7,981.27 penalty, plus interest.

(ii) Period June 1, 1985 through February 28, 1987, omnibus penalty \$1,688.59.

(b) To Haresh Khiani, as officer of S & K Smoke Shop, Inc.:

(i) Period November 1, 1983 through February 28, 1987, \$31,700.47 tax, \$7,981.27 penalty, plus interest.

(ii) Period June 1, 1985 through February 28, 1987, omnibus penalty \$1,688.59.

(c) To Barbhai Savalia, as officer of S & K Smoke Shop, Inc.:

(i) Period November 1, 1983 through February 28, 1987, \$31,700.47 tax, \$7,981.27 penalty, plus interest.

(ii) Period June 1, 1985 through February 28, 1987, omnibus penalty \$1,688.59.

Petitioners filed a timely request for a conciliation conference with the Bureau of Conciliation and Mediation Services. Pursuant to the conference, a second observation test was performed on November 1, 1988, also a Tuesday, showing total sales of \$382.00 with \$140.00 taxable and \$242.00 nontaxable. It was noted that at that time cigarettes were sold for \$1.40 per package. The results of the two observation tests were averaged for new audited daily sales of \$567.00 and a new taxable percentage of 43%. The new hourly gross of \$71.00 was multiplied

³Note that the tax assessed (Finding of Fact "4") is \$31,700.47, due to application of the error percentage to taxable sales reported on a quarterly basis.

by 54 hours per week (as petitioners claimed the business had been open only six days per week for most of the audit period), resulting in audited gross sales of \$664,560.00 for the audit period. After applying the revised taxable percentage of 43%, the revised audited taxable sales were determined to be \$285,761.00 and additional taxable sales \$212,793.00. The percentage of error was reduced to 291.62% and additional tax due was reduced to \$17,555.04. The omnibus penalty was reduced to \$935.10. Petitioners refused to sign a withdrawal for the reduced amounts, and filed a petition for a hearing.

The corporation acquired the business in or about November 1983. The business was open six days per week (closed on Sunday) from the inception until early 1986. Prior to 1986, the business was able to isolate its space with a gate on Sundays when the Woolworth store was open. After that time, an adjacent concessionaire was open for business on Sunday requiring the gate to be open. Accordingly, the corporation also opened for business on Sunday, even though sales were slow, in order to protect its merchandise from theft. The business hours were as follows:

10 A.M. to 5:45 P.M. on Tuesday, Wednesday and Saturday;
10 A.M. to 7:45 P.M. on Monday, Thursday and Friday;
and 11:00 A.M. to 4:45 P.M. on Sunday.

During the Christmas season, the business was open for approximately one hour later.

During 1983, petitioner sold cigarettes for approximately \$.95 per package.

At the hearing, petitioners offered a document purporting to be the corporation's cash receipts book, which listed taxable and nontaxable sales on a daily basis ranging from October 31, 1983 to February 27, 1987. This document, however, must be discounted as unreliable since it shows no Saturday or Sunday sales. According to the auditor, petitioners claimed that weekend sales were probably included with Monday sales. However, perusal of the record shows that Monday sales were not disproportionate to sales for other days of the week.

At the request of the Administrative Law Judge, petitioners submitted the corporation's

weekly lottery statements from the New York State Division of Lottery. Analysis of the statements shows that there is virtually no correlation between the weekly net lottery sales and the sales shown in the cash receipts book. Lottery sales appear to be fairly consistent over the audit period, although certain weeks were substantially higher than others, possibly reflecting activity due to an unusually high jackpot offered during such weeks.

CONCLUSIONS OF LAW

A. During the period in issue, Tax Law § 1138(a) (former [1]) provided, in pertinent part, as follows:

"If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission 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."

B. Where a taxpayer's records are incomplete or insufficient, the Division of Taxation may select a method reasonably calculated to reflect the sales and use taxes due. The burden then rests upon the taxpayer to demonstrate by clear and convincing evidence that the method of audit or amount of tax assessed was erroneous (Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858).

C. The records of S & K Smoke Shop, Inc. were clearly incomplete and insufficient. Accordingly, it was proper for the Division of Taxation to estimate taxes based on an observation of the business. However, allowance should have been made to reflect lower prices which prevailed in the periods well before the dates of the observation tests. For example, the first observation test was based on prices for August 1986, which is almost three years after the beginning of the audit period, and about six months prior to the end, while the second observation test was based on prices for November 1988, which is five years after the beginning of the audit period and more than twenty months after it ended. As Findings of Fact "5" and "7" indicate, cigarette prices in November 1988 were \$1.40 per package, while the 1983 prices were approximately \$.95 per package. Accordingly, audited sales are to be reduced to \$509.10 per day and the taxable percentage to 41%. This results in audited taxable sales of \$244,224.86

and tax due of \$14,130.34.⁴

D. Except as set forth in Finding of Fact "5" and Conclusion of Law "C", petitioners have failed to sustain their burden of proof to show that the method of audit or amount of tax assessed was erroneous.

E. The petition of S & K Smoke Shop, Inc. and Haresh Khiani and Barbhai Savalia, as officers, is granted to the extent of the inflation adjustment set forth in Conclusion of Law "C". The notices of determination and demands for payment of sales and use taxes due issued to petitioners on December 20, 1987 are to be modified in accordance therewith and with the adjustment made at the Bureau of Conciliation and Mediation Services conference (Finding of Fact "5"). Except as so granted the petition is in all other respects denied.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE

⁴Official notice has been taken of the United States Bureau of Labor Statistics consumer price index for the New York City area, Table No. 764, Statistical Abstract of the United States, 1990 Edition, which provides the following indices for the years at issue: 1983-99.8, 1984-104.8, 1985-108.7, 1986-112.3, 1987-118.0, 1988-123.7. Such notice has also been taken of the producer price index for cigarettes, *id.* at Table No. 774, which provides the following indices for selling prices of cigarettes during the years at issue: 1983-93.5, 1984-102.3, 1985-110.7, 1986-120.9, 1987-133.4, 1988-150.6. The consumer price index has been applied to nontaxable sales and the producer price index to taxable sales.