STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of **ALBERT SALESE, FRANK SALESE AND MARK SALESE T/A[1] JUNIORS** 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, 1990 through November 30, 1993.	:	DETERMINATION DTA NO. 815351

Petitioners, Albert Salese, Frank Salese and Mark Salese t/a Juniors, 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 December 1, 1990 through November 30, 1993.

A hearing was held before Roberta Moseley Nero, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on June 3, 1997 at 10:15 A.M., and continued and concluded on July 28, 1997 at 10:15 A.M., with all briefs to be submitted by January 29, 1998, which date began the six-month period for the issuance of this determination. Petitioners appeared by Neil B. Fang and Jerri A. Cirino, Esqs. The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (James Della Porta and Marvis A. Warren, Esqs., of counsel).

ISSUES

I. Whether the unsworn statement of Mr. Joseph David should be admitted into evidence.

[1]"Transacting as".

II. Whether the indirect audit methodology utilized by the Division of Taxation was reasonable.

III. Whether the evidence produced at hearing by petitioners requires any adjustments to the audit results.

FINDINGS OF FACT

1. Petitioners are partners in the business of operating pizzerias, or "family restaurants" in Long Island, New York. During the audit period petitioners operated three stores all of which were called Juniors. The store in Northport, New York (hereinafter "Northport") was a small store front operation with no seating[2], and most closely resembled a pizzeria. The store in Halesite, New York (hereinafter "Halesite") had eight booths and stools, and was described as "more of a family restaurant, not just your plain old pizza store" (Tr. p. 168). The store in Huntington Village, New York (hereinafter "Huntington") had approximately eight tables and stools, with an atmosphere somewhere between that of the Northport and Halesite stores.

2. The Division of Taxation (hereinafter "Division") commenced a sales tax audit of petitioners' business, and on February 28, 1994 an appointment letter was sent to petitioners' then representative Arthur Wigutow, a public accountant, (hereinafter "accountant") by Elaine Sullivan, the Division auditor assigned to this case. The letter provided that:

> All books and records pertaining to your Sales and Use Tax liability for the period under audit are to be available on the appointment date. This would include journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns, and exemption certificates. *Exemption certificates not made available may be disallowed in which case you will be held liable for the tax on the transaction.*

[2]There were stools in the Northport pizzeria, but these were only available for use while waiting for take-out orders. There were many problems with the physical facilities at Northport, the lack of seating being one of them, and the pizzeria was moved next door in 1994.

> During the course of the audit, you may be required to furnish additional records and/or information." (Division's Exhibit G; emphasis in original.)

3. In response to the request for petitioners' books and records, petitioners provided the Division with: certain worksheets prepared by their accountant; a daybook; and certain purchase invoices from Lisanti Foods Inc. and Vesuvio Foods. Petitioners did not retain any guest checks and had some register tapes only from the end of the period, and it could not be determined which store or stores they were from. The daybook consisted of sales for all three stores grouped together. A total number for each three-day period was listed and a weekly total was computed. The amounts on the purchase invoices provided by the representative were significantly higher than those recorded in petitioners' books. The Division determined, on the basis of no source documentation and the inability to tie the records provided with the books supplied, that petitioners' books were unreliable and that an indirect audit method would have to be utilized.

4. Mark and Albert Salese testified that, while guest checks were used for their own ordering purposes and for informing the customers of the cost of the order, no guest checks were kept. They further testified that they did not keep any type of journals or copies of bank statements or canceled checks, and they could not explain the discrepancies between the purchases recorded on the books and the purchase invoices as determined by their accountant or the subpoenaed purchase records. They basically testified that their accountant prepared the sales tax returns and they had nothing to do with the bookkeeping. They only signed the returns and the required checks. Petitioners' accountant was present at the first day of the hearing but did not testify. Mark and Albert Salese testified that he was a family friend and had always been their accountant. He did not appear or testify at the second day of the hearing because of his ill health.

5. An observation of all three businesses was conducted by two investigative aides employed by the Division, Linda Caracappa and Tom DiRusso, on three different Thursdays in May 1994. The investigators had several problems with the reliability of the observation test. They observed that prices charged during the observation were sometimes lower than those on the menu; that sales tax was sometimes charged and sometimes not; that large pizzas were sold for medium prices; that the telephones at the stores were left off the hook or used excessively for personal purposes; and that the stores closed earlier than they were supposed to (pursuant to phone calls the investigators placed to each of the stores to ascertain the operating hours).

Mark and Albert Salese explained that: differences in pricing and charging of sales tax on the observation days were due to nervousness; the phones were only used for business purposes or for the normal amount of family calls; that it was their policy to close the stores early when there were no customers; and that the stores tended to be busier in the summertime.

6. Petitioners refused to provide Lisanti Foods, Inc., one of their main suppliers, with authorization to release their purchase records to the Division. Therefore, the Division subpoenaed the purchase records from Lisanti Foods, Inc. for the audit period. Flour was purchased from Lisanti Foods, Inc. in 50-pound bags. The amount of flour purchases was converted into the number of dough balls that could be made from each bag of flour. The figure utilized was 34 dough balls per 50-pound bag of flour. The observations were used to determine the ratio of meal sales to dough product sales and to calculate the average price of the dough products sold.

Weekly flour purchases (from the subpoenaed Lisanti purchase records) were multiplied by 34 (the number of dough balls per bag of flour) to arrive at total dough balls available per week. The total number of dough balls available per week was then multiplied by the average selling

price per dough ball (calculated based on the observation day) to arrive at taxable dough sales. To arrive at the average price of the dough products sold the total sales in dough products for the day (the dollar amount) was divided by the number of dough balls used that day (the number of dough balls used per day was calculated by dividing the actual number of a certain item sold that day by the number of portions of that particular product contained in one dough ball).

Ratios of soda sales and meal sales to sales of dough products for the observation day were arrived at by dividing the dollar amounts sold of each during the observation day by the total dollar amount of the dough products sold that day. Each of these numbers was multiplied by the taxable dough sales per week to arrive at a dollar figure for taxable soda sales and taxable meal sales for the week.

Taxable dough sales for the week were added to taxable soda and taxable meal sales for the week to arrive at audited weekly taxable sales. The audited weekly taxable sales for each store were added together to obtain a total audited weekly taxable sales figure. This number was then multiplied by 13 weeks per tax quarter and then again by 12 quarters in the audit period to arrive at total audited taxable sales. Reported taxable sales were subtracted to arrive at additional taxable sales due. Additional taxable sales due were divided by reported taxable sales to arrive at a margin of error of 5.91%. This margin of error was applied separately to the reported taxable sales of each quarter to obtain additional taxable sales for each quarter and then multiplied by the appropriate tax rate to arrive at tax due.

7. The Division issued a Statement of Proposed Audit Adjustment dated February 10, 1995 in the amount of $202,848.12 in tax due plus penalty (both statutory and omnibus penalty for underreporting in excess of 25%) and interest. Petitioners disagreed and on March 9, 1995 a meeting was held at petitioners' accountant's office and attended by the auditor, the auditor's

team leader, the accountant and Albert and Mark Salese. Petitioners submitted written disagreements and alternative calculations prepared by their accountant. Petitioners argued that the Division's calculations failed to take into account cheese purchases, another major ingredient in making pizzas. An alternative calculation was prepared based on flour and cheese purchases and a ratio of one case of cheese used for every 50-pound bag of flour (based on a recipe using one and one-half pounds of cheese per pizza). Petitioners used this formula to determine an average number of pies produced per week. Petitioners then deducted flour purchases not used for pizza pies but for: baked products (breads, dinner rolls, etc.); personal use of partners and families; sales to Pomodoro Restaurant, a traveling carnival and others; dusting or peel; and spoilage. In calculating additional taxable sales petitioners made allowances for lower prices for the first two years, the claimed nonownership of Northport until March 1, 1992 and the inclusion of sales tax in the selling price of the products. Petitioners' calculations produced a tax due of $55,736.76.

8. As documented in the audit report, the Division's response to petitioners' contentions was that: cheese purchases were not utilized because cheese is used in many other products for sale and the auditor did not have all of the cheese purchase records from Vesuvio Foods; all dough products sold were included in the average selling price calculations; dusting was included by allowing only 34 dough balls per 50 pound bag of flour; sales to other restaurants or carnivals were not documented during the audit, nor did they appear in the books provided by petitioners; lower prices during the audit period were not proven by menus or other means; and sales tax was not included in prices because there was no sign stating so.

9. In August of 1994, the Division conducted another observation of the three stores. This observation was apparently done from outside of the restaurant and was done only for evening

hours. This was to verify the auditor's suspicions that the stores were really open later than when they closed on the observation day. According to these observations the stores were open later than on the original observation days.

10. The Division issued a revised Statement of Proposed Audit Adjustment, also dated February 10, 1995, in the amount of $210,691.02 in tax due plus penalty (both statutory and omnibus penalty for underreporting in excess of 25%) and interest. This statement was to correct an error in calculations that occurred because the prices observed by the investigative aides on the observation day had been utilized in the calculations rather than the prices from the menus for that time period. The prices charged on the observation day were lower than the menu prices.

11. The Division issued a Notice of Determination to petitioners dated May 12, 1995. The Notice of Determination reflected tax due of $210,691.02, interest of $76,684.66 and statutory and omnibus penalties of $83,001.66, for a total balance due of $370,377.34.

Petitioners filed a request for a conciliation conference and a conciliation order was issued on June 21, 1996 sustaining the statutory notice. Petitioners filed a petition protesting the conciliation order which was received by the Division of Tax Appeals on September 16, 1996.

While listing $210,691.02 as the amount of tax determined to be due by the Division, the petition listed the amount of tax contested as $158,579.60. This was explained in paragraph six of item six of the petition, where petitioners asserted that they had arrived at a tax due in the approximate amount of $52,000.00. On March 20, 1997, the Division of Tax Appeals received a Notice of Partial Withdrawal of Petition and Discontinuance of Proceeding from petitioners. The notice explained that petitioners had filed amended returns showing a total sales tax due of $52,627.86 and had applied for amnesty regarding these amounts. The difference between the

amounts of tax due set forth on the amended returns and the amounts set forth in the notice, is the amount remaining at issue in this matter as set forth in the following chart.

Quarter Ending	Tax Due per Amended Returns	Tax Due per Notice	Tax Remaining at Issue
February 28, 1991	$3,361.05	$13,457.93	$10,096.88
May 31, 1991	$2,878.65	$11,526.30	$8,647.65
August 31, 1991	$2,595.90	$10,394.25	$7,798.35
November 30, 1991	$3,084.72	$12,351.44	$9,266.72
February 29, 1992	$2,796.96	$11,199.20	$8,402.24
May 31, 1992	$5,002.80	$20,031.60	$15,028.80
August 31, 1992	$5,018.08	$20,092.56	$15,074.48
November 30, 1992	$5,033.11	$20,152.74	$15,119.63
February 28, 1993	$5,386.96	$21,569.94	$16,182.98
May 31, 1993	$5,352.54	$21,431.73	$16,079.19
August 31, 1993	$5,532.65	$22,153.13	$16,620.48
November 30, 1993	$6,584.44	$26,330.20	$19,745.76
Totals	$52,627.86	$210,691.02	$158,063.16

12. In the operation of the three stores, petitioners make their own pizza dough. Flour is purchased by the 50-pound bag. A 50-pound bag of flour is dumped into a dough maker with three and one-half gallons of water, salt, sugar and yeast. Once this is mixed together, the dough gets weighed out and apportioned into dough balls. The dough balls are then stacked in tins.

The Division's calculations utilized the figure of 34 dough balls per 50-pound bag of flour. The auditor testified that the number of 34 dough balls per 50-pound bag of flour was provided

to her by petitioners' accountant.[3] The auditor testified that in her experience[4] this number was extremely low, and that she generally calculated using a figure of 43 to 55 dough balls per 50-pound bag of flour. The figure of 34 dough balls per 50-pound bag of flour is premised on petitioners' regular dough balls weighing between 2¼ and 2½ pounds and Sicilian dough balls weighing between 3¼ and 3½ pounds and petitioners' making 28 regular dough balls and 4 Sicilian dough balls per 50-pound bag of flour. The weight of the dough after the flour is mixed with the other ingredients is approximately 75 to 80 pounds per 50-pound bag of flour. Averaging the size of the dough balls, the calculations are as follows:

28 x 2.375 = 66.5
4 x 3.375 = 13.5
Total 80 pounds

The auditor testified that she utilized the number of 34 dough balls per 50-pound bag of flour in hopes of reaching an agreed result to the audit. She further testified that by utilizing what she considered a low number she would account for flour used for dusting or peel, any waste or family use and for different size pies. This number was also to account for petitioners' pies being unusually heavy. The auditor testified that a 12-ounce dough ball would be standard to make an 18-inch pie.[5] Investigator Caracappa went to each of the three stores unannounced and weighed two dough balls in each store. She found the dough balls to weigh between two and one-quarter to two and one-half pounds for the smaller of the dough balls, and between three and one -quarter

[3]The written calculations submitted by the accountant utilize 34 dough balls per 50-pound bag of flour.

[4]Ms. Sullivan holds a four year degree in accounting and has received additional training from the Division. She is currently a Tax Auditor I in the Division's Suffolk District Office and has been in that position for 15 years. During her 15 years with the Division she has performed numerous audits of pizzerias, she estimated that she had probably done more than 30 such audits.

[5]If 12 ounces of dough per 18-inch pizza is utilized, the result is 107 dough balls per 50 pound bag of flour, or approximately twice the number of dough balls the auditor stated.

and three and one-half pounds for the larger of the dough balls. The dough balls were selected and weighed by one of the petitioners in each store with the investigator watching. The investigator did not ask to weigh particular dough balls. The auditor testified that there was no way for her to know what these particular dough balls were made into, or if there were other size dough balls. She frankly testified that she was not comfortable with the 34 dough balls per 50-pound bag of flour number, even after the Division's investigator had weighed the dough balls.

Mark and Albert Salese testified that they consistently obtained 32 dough balls per 80 pounds of dough (or 50-pound bag of flour), and that they have an unusually thick or heavy pizza crust. They further testified that there was no reason to make allowances for different size dough balls in calculating how many dough balls per 50-pound bag of flour because they only made those two sizes of dough balls. They explained that the larger dough ball was used for a Sicilian pizza and the smaller dough balls were used for everything else as follows: 1 dough ball for 18-inch and 16-inch pizzas; 3 personal pizzas, calzones or stuffed breads (for example, sausage

stuffed bread) per dough ball; 24 zeppolis or garlic knots per dough ball.[6] Petitioners' calculations as set forth in their brief are as follows:

28 x 2.25 = 63
4 x 3.125 = 12.5
Total 75.5 pounds

13. There was testimony presented by both parties on the issue of the size of the pizzas sold by petitioners. The auditor testified that petitioners sold 10-inch (personal), 14-inch (bar), 16-inch and 18-inch pizzas. Mark and Albert Salese testified that they did not sell a 14-inch pie even though that is what appears on the menu; it was a 16-inch pie. Mark and Albert Salese also testified they sold stuffed pizza (with two doughs - probably one a day). There seems to be no issue that petitioners also sold Sicilian and deep dish pizzas. The menu states that petitioners sell 10-inch (personal), 14-inch (bar), 18-inch, Sicilian and deep dish pizzas.

14. The auditor testified that high-gluten flour, while used to make various dough products other than pizza, is not used to make bread that would be given complimentarily with meals or for hero rolls. She stated that making these types of breads was not usually done in the operation of a pizzeria. However the auditor did state that focaccia bread could be made from the high-gluten flour dough balls. When questioned on cross-examination whether it is customary practice, based on her experience, for complimentary bread to be given with dinners, including take-out dinners, the auditor stated that for the more restaurant type of pizzeria, with dinners like seafood on the menu, it would be customary, implying that for plain pizzerias it would not be. She did not directly answer the question regarding petitioners' stores, but noted that there were

[6]The Division's observations were based on the same principal, but with different numbers. The Division utilized 8 slices of regular pizza or 9 slices of Sicilian per dough ball, 1 18-inch or 14-inch pizza per dough ball, 2 personal pizzas per dough ball, 4 calzones per dough ball, and 40 garlic knots per dough ball.

no notations in the audit workpapers indicating whether the investigators saw complimentary bread served with the dinners or take-out dinners.

Petitioners introduced affidavits from two customers, Joanne Lombardo and Rose Ambrosio, each indicating that they were not either family members or personal friends of petitioners, and, furthermore:

> 3. During the period of December 1, 1990 to November 30, 1993 my family and I purchased pasta and dinners from the Petitioner, Junior's Pizzeria, on a regular basis.
> 4. Each and every time I ordered the above mentioned food, it came with complimentary breads and we never paid for the breads. (Petitioners' Exhibits 5, 6.)

Mark and Albert Salese testified that they had always made complimentary bread to go with dinners from the dough balls because their father had taught them to do it that way. Petitioners also introduced a commercial bread wrapper listing high-gluten flour in the list of ingredients. Mark and Albert Salese stated they made different kinds of bread: Italian bread, hard bread, loaf bread and focaccia. They testified that one dough ball would make enough bread for two to four dinners.

Mark and Albert Salese also testified that they made their own rolls for heros, other than the rolls for "footers" (six-foot hero). The rolls for the "footers" were obtained from a deli or from the supermarket. Petitioners also ordered rolls for special occasions, such as Cow Harbor Day in Northport, because of the volume required. Then Mark and Albert Salese testified that sometimes they ordered hero rolls. Furthermore, they admit on rare occasions having purchased bread products from Joseph David and stated that during the audit period he was the only outside supplier they used. Mark Salese testified that Joseph David was not reliable, he would either not deliver when he should or he would deliver the wrong item. This led to an argument between

Mark Salese and Joseph David and petitioners no longer order any bread products from Joseph David. Albert Salese testified that purchases from Joseph David were not made on a frequent basis, "it wasn't on a daily basis — maybe on a weekly basis, but not much at all" (Tr. p., 46). Finally, they testified that they currently do purchase their hero rolls from a third party.

Marked into evidence as the Division's Exhibit R[7] was a one-page handwritten, unsworn statement signed by Joseph David.

> I Joseph David have established a bread route delivering Italian bread and rolls. I purchase bread and rolls at wholesale prices from Modern Italian Bakery located in Oakdale, N.Y. and deliver to my customers. I bill and collect the monies directly to my customers.
>
> I have been servicing Junior's Pizzas' three locations - Northport, Halesite, Huntington Village during the periods 12/1/90 through 11/30/93. I have had Junior's Pizza as a customer for the past ten years until approximately six months ago.
>
> I delivered approximately (blank space) heros and club rolls on a consistent (blank space) basis to each store during the periods 12/1/90 through 11/30/93.
>
> Halesite Store - 150 heros per week
> Huntington Village - 50 heros per week
> Northport - 50 heros per week
>
> 120 club rolls on Cow Harbor Day to the Northport Store. (Division's Exhibit R.)

Investigator Caracappa testified that after the completion of the first day of the hearing and prior to the second day, she contacted the Modern Italian Bakery and asked if petitioners purchased hero rolls from them. The bakery referred her to Joseph David, who had an independent route and she called and left a message for him. Joseph David returned her call when she was not in, so he spoke with the auditor. He told the auditor that he had delivered hero rolls on a daily basis to Juniors' three locations for a period of ten years, ending approximately six months prior to the

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[7]The decision as to whether to admit this exhibit into evidence was reserved for this determination. See, Conclusion of Law "A".

conversation. The investigator then prepared a statement on the basis of what Mr. David told the auditor. The investigator met Joseph David at a diner and he gave her the information needed to "fill in the blanks" (i.e., the quantity of rolls sold). She in turn added this to the information in the statement she had prepared. The investigator saw Joseph David sign the statement. He told the investigator that he delivered the rolls on a daily basis, in the middle of the night using a key supplied by petitioners.

Mark and Albert Salese testified that Joseph David had difficulties with the English language and could not have understood what he was signing. The investigator testified that while he spoke with an accent he comprehended their conversation and he did understand what he was signing.

15. Petitioners introduced the affidavit of Eric Machado which provided:

> 1. I am currently employed and was employed during December 1, 1990 to November 30, 1993, as the manager of the following two Italian Restaurants: a) Pollo Pazzo, located at 364 New York Avenue, Huntington, New York; b) Pomodoro Restaurant, located at 62 Stewart Avenue, Huntington, New York.
> 2. I am not a family member or a personal friend of any of the Petitioners.
> 3. My duties as Manager always included purchasing food products for both restaurants. We currently purchase dough balls from the Petitioner, Juniors Pizzeria and during the period of December 1, 1990 to November 30, 1993 we purchased thirty (30) dough balls per day, seven days each and every week during the above stated period, from Juniors Pizzeria. We paid fifty (50) cents per dough ball for each purchase. Said amount was regularly remitted to Petitioners.
> 4. The purchased dough balls were and are used by our chefs to bake fresh bread products for both of our restaurants on a daily basis." (Petitioners' Exhibit 7.)

Mark and Albert Salese testified that they sold dough balls to Pomodoro and Pollo Pazzo restaurants during the audit period. They explained that the restaurants were and are owned by Fabio Machado, who now owns approximately eight restaurants; at the time of the audit period it

was probably around four. Mark and Albert Salese testified that they sold 20 dough balls per day during the audit period to Pomodoro to use for complimentary bread products to be served with its dinners — Pomodoro was more of a restaurant — and 20 dough balls per day to Pollo Pazzo to use for their chicken sandwiches — this was more of a sandwich shop. Mark and Albert Salese testified that they sold the dough balls for 50 cents, which meant that very little money was made, but some was made and they were helping out another neighborhood restaurant. The bulk of the sales — the 20 per day to Pollo Pazzo — were from Huntington which is why its flour purchases were relatively higher than the other stores. Fabio Machado was not involved in any of these transactions; they were handled by his son Eric Machado.

Investigator Linda Loesch, another Investigative Aide with the Division, testified that between the two days of hearings she went to Pomodoro on two occasions. On the second occasion she spoke with Fabio Machado who confirmed that Juniors did supply him with dough balls during the audit period. However, he stated that it was 30 dough balls per week rather than 30 dough balls per day as stated in Eric Machado's affidavit. Furthermore, he stated that the dough balls were used strictly for Focaccia bread which was given out complimentary with the meals. He also stated that he was not at the restaurant that much and if further details were needed she should contact Dean Coyes, the bookkeeper, and provided his telephone number. Fabio Machado stated that he was not sure of the size of the dough balls except that it had to be more than one pound because they were used in making one-pound breads. Dean Coyes confirmed that 30 dough balls per week were purchased from Juniors during the audit period.

The Division introduced a Suffolk County sewerage review form and a Suffolk County food establishment permit. The Sewerage Review Form lists: an application date of April 1, 1994; the name and address of the establishment as Pollo Pazzo, Inc., 366 New York Avenue,

Huntington; the name and address of the applicant as Fabio Machado for Pollo Pazzo, Inc., 56 Stewart Avenue, Huntington; the type of previous operation as a shoe store; and reason for the application listed as a new operation. The Food Establishment Permit Application lists the same name and address for the establishment, a billing and mailing address for Pollo Pazzo at 56 Stewart Avenue, Huntington, describes the establishment as a take-out restaurant with no seating and is signed by Fabio Machado as Secretary. The dates listed indicate the application was signed on March 28, 1994, $250.00 was paid on April 5, 1994, the permit was issued on June 14, 1994, and the expiration date was June 30, 1995. The auditor testified that Division sales tax records indicate that Pollo Pazzo started business in 1994, kept its corporate name but changed its d/b/a in 1995 to United Sandwiches, and appears active only for 1994 and 1995. A search of the sales tax records for Pomodoro revealed addresses at 56 Stewart Avenue and 62 Stewart Avenue. Pomodoro's returns were not reviewed to determine if they contained sales tax for Pollo Pazzo for the years prior to 1994.

Investigator Loesch also spoke with a Juan Gomez who was the manager of Pomodoro Restaurant and Market. He had worked for Fabio Machado during the audit period and corroborated the information provided by Fabio Machado and Dean Coyes that 30 dough balls per week were purchased from Juniors during the audit period.

16. Mark and Albert Salese testified that they provided dough balls to Ian Mulligan who made pizzas for Newton & Sons which sold them at various carnivals from Memorial Day through Labor Day. They further testified that the amount of dough balls depended on the particular carnival. Huntington, for example, was rather large, probably 40 dough balls a day. According to petitioners there was a carnival every weekend during the summer, some were two days, some were four. Petitioners have no records as to the amount of dough balls used by

Ian Mulligan. He had been partners with Frank Salese, Jr. in Northport prior to petitioners' taking over Northport. Petitioners inferred that since when they took over there was no longer a partnership relationship, that Frank Salese, Jr. had owed Ian Mulligan money. Ian Mulligan would come into the Northport store to make his pizza dough. Petitioners are not even sure that they were paid for the flour. Sometimes they would just sell him the dough balls. His dough usage probably amounted to a couple of bags of flour a week. There is no documentation to support the sales to Ian Mulligan, and he refused to sign an affidavit when requested to do so by petitioners.

Investigator Caracappa spoke with Michael Newton from Newton & Sons and as a result of that conversation Michael Newton submitted the following unsworn statement:

> Lewis J. Newton & Sons, Inc. supplies outdoor amusements to various not-for-profit organizations. We do not have a tax exempt number.
>
> Newton & Sons did not employ Ian Milligan as a pizza chef or other in the years 1991, 1992 and 1993.
>
> To the best of our recollection Mr. Milligan sold pizza at our carnival two times in 1991 and 3 to 4 times in 1992 and 1993. I am not sure whether Mr. Millian [sic] baked the pizzas at the carnival or somewhere else. It was probably a combination of both. (Division's Exhibit P.)

Investigator Caracappa testified that she did not speak with Ian Mulligan due to the fact that there was not time between the two days of the hearing. Furthermore, she pointed out that while petitioners referred to him as Mulligan, Michael Newton spelled the name Milligan. She did locate an Ian Milligan in the phone book for Huntington.

17. Petitioners introduced an affidavit from Steve Hamby who operates a lunch truck which provided:

1. I reside in East Northport, New York and am currently self-employed and operate a lunch truck which sells food at numerous business sites during coffee breaks and lunch time.
2. I am not a family member or a personal friend of any of the Petitioners.
3. During the period of December 1, 1990 to November 30, 1993, I purchased twelve (12) pizza pies each and every week from the Petitioner, Junior's Pizzeria, for resale to my customers. Since I purchased the pizza pies in such a large quantity on a consistent basis from the Petitioner, he discounted the price I had to remit. Said price never included sales tax.
4. To date, the Petitioner is still my primary supplier of pizza pies for resale and I currently purchase the same amount of pies for resale. (Petitioners' Exhibit 8.)

18. In about 1985 Frank Salese, Jr. (son of petitioner Frank A. Salese and brother of petitioners Mark and Albert Salese) opened up Juniors One in Halesite with funds he received in settlement of a motorcycle accident. After about two and one-half years Frank, Jr. left the business and moved to Pennsylvania. The business was not in good shape. Albert took over the business. After several years in Pennsylvania, Frank, Jr. had failed in a business venture there and returned to New York. Frank, Jr. and another brother Michael, decided to open Juniors of Northport. Then Albert and Mark decided to open Juniors of Huntington in order to generate a lunch trade. (The Halesite location was more of a dinner crowd and was slow during lunch.) The partnership between Frank, Jr. and Michael broke up and Frank, Jr. was running Northport on his own. Sometime prior to petitioners taking over Northport, Michael returned to work with Frank, Jr. again. Their suppliers had discontinued any credit arrangements and they were required to pay C.O.D. for any deliveries. This was the same type of situation Frank, Jr. had found himself in with Juniors in Halesite and then again in Pennsylvania. Furthermore, the landlord was not going to renew the lease. Albert and Mark did not want to let a "Juniors" go out of business, since it was so close to the other locations. Therefore they signed a new five-year lease in November of 1991 and guaranteed Lisanti Foods, Inc. that they would pay the bills in order to get deliveries.

Mark and Albert testified that Frank, Jr. continued to run the business until after the holidays and that they took over sometime in early 1992 (January, February or March of 1992).

Included in the Division's audit workpapers are seven invoices from Lisanti Foods, Inc. made out to "JUNIORS OF NORTHPORT AL/MARK SALESE" for November and December of 1991, the earliest being dated November 14, 1991. (Division's Exhibit G, Attachment.) The Division also introduced what it purports are Suffolk County Department of Health Services Food Establishment Permits running from July 1 to June 30 of any given year. The first of these was signed by Frank, Jr., the second by Michael and the third signed by petitioner Frank A. Salese. The Division claims that the these "permits" run from July 1, 1989 to June 30, 1990, July 1, 1990 to June 30, 1991 and July 1, 1991 to June 30, 1992, respectively. The Division contends that, since the permit running from July 1, 1991 to June 30, 1992 was signed by one of the petitioners, it should be implied that petitioners took over the Northport store in 1991. The photocopies of the documents submitted by the Division are not food establishment permits. The documents clearly indicate that they are bills for the renewals of such permits. The instructions are for the applicant to sign the bill and return it to the Department of Health Services with payment. The bill signed by Frank A. Salese states that the permit expiration date is June 30, 1992, the fee is $200.00 and the fee reflects 1992 rates. Furthermore, it is marked received by the Department of Health Services on June 29, 1992. Therefore, the document signed by Frank A. Salese was a bill for the period July 1, 1992 to June 30, 1993 and is thus consistent with petitioners' contention that they did not take over the store until 1992.

19. The auditor testified that amounts of flour used for peel or dusting were accounted for when she agreed to utilize the number of 34 dough balls per 50-pound bag of flour, which she contended was low based on her experience. The parties agree that the terms peel or dusting refer

to the practice of using flour to keep the dough balls from sticking to surfaces. The auditor testified that the amount of flour used in this manner is minimal. Mark and Albert Salese testified that every Monday they pour one 50-pound bag of flour into a pail in each store and that is what is used for dusting. Furthermore, Mark and Albert Salese disagreed with the auditor's assertion that only a minimal amount of flour was used for dusting. They explained that flour was inexpensive and the process of dusting or peel was necessary to make the dough into a pizza and not using enough flour in the process would make the dough useless. Since the flour was inexpensive it would not make sense to be ungenerous with the flour in this process.

20. The auditor testified that waste or spoilage and personal use were again accounted for by using the low figure of 34 dough balls per bag of flour. Mark and Albert Salese estimated that approximately one 50-pound bag of flour for each store went to waste or was consumed by the families per week. They testified that waste included such things as slice pies that were left over and thrown out or given away, and mistakes in making the dough. They also testified that some mistakes could be made into other products such as garlic knots and that waste and personal use sometimes overlapped because family members would take the leftovers. Petitioners had a large family and personal usage occurred on a regular basis including some family members' taking home raw dough balls.

21. The two affidavits introduced by petitioners from their customers (***see***, Finding of Fact "14", Petitioners' Exhibits 5,6) included a statement that sales tax was included in all their purchases at Juniors and not stated separately. Mark and Albert Salese testified that sales tax was included in all their sales and that was the way their father had always done it. Customers at all three Juniors received a guest check indicating what they had ordered and the price. These guest checks were not maintained by petitioners. There were no signs in any of the locations indicating

that sales tax was included in the prices. There was no indication on any of the menus in the record that sales tax was included in the prices. On the observation days, sometimes sales tax was charged separately, sometimes not.

22. The Division agreed, prior to closing of the second day of the hearing in this matter, that it would investigate through its own records, the tax exempt status of the Northport Fire Department, the Y.M.C.A. of Long Island, the Helen Keller Services for the Blind and the American Legion Northport Post. The Division in its brief confirms that all of theses entities were tax exempt organizations (Division's brief, p. 16).

23. With regard to the Northport Fire Department the Division states in its brief that credit should be given to petitioners for documented nontaxable sales. The Division contends that these documented sales are found in petitioners' Exhibits 12 and 16. Petitioners' Exhibit 16 consists of 42[8] vouchers from the Northport Fire Department made out to Juniors and listing various voucher numbers between the numbers 1407 and 1978 and between the dates January 26, 1992 through December 6, 1993.[9] The total amount of purchases by the Northport Fire Department pursuant to these vouchers was $1,701.50.

Petitioners introduced the affidavit of Bob Guinn, Fair Chairman for the Northport Fire Department during 1992 and 1993. The affidavit states that in that capacity he purchased 80 pizzas each year for the fire department's annual summer carnival from Juniors. Investigator Loesch went to the Northport Fire Department between the two days of hearings. She asked

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[8]There are actually 43 vouchers. However, voucher number 1777 has not been counted since it does not contain an amount.

[9]Exhibit 12 was voucher number 2011 and while marked for identification is not part of the record. At the time presented petitioners were to make copies and present it at the second day of hearings, instead petitioners decided to substitute Exhibit 16.

whether vouchers existed to document the carnival sales set forth in the affidavit. She spoke with the treasurer who agreed to list all the purchases for the investigator. This was done and introduced into evidence as Petitioners' Exhibit 23. There are three parts of the list for three separate fire company accounts. For each of these there is a list by date of check numbers and amounts. For the 3 combined lists there are 2 1990 transactions, 18 1991 transactions, 16 1992 transactions, and 16 1993 transactions. Of these, the following are noted to be fair transactions: December 14, 1991, check number 5327, $973.00; March 7, 1993, check number 5979, $530.00; and, September (unreadable), 1993, check number 6279, $432.50.

24. With regard to the Y.M.C.A. of Long Island, petitioners introduced the affidavit of Karen Blackburn which provided:

> 1. I am not a family member or a personal friend of any of the Petitioners.
>
> 2. I served as the Camp Director, Y.M.C.A. of Long Island, located at 62 Main Street, Huntington, New York, during the 1991, 1992 and 1993 calendar years.
>
> 3. During the above stated years, the Y.M.C.A. of Long Island had a valid New York Tax Exempt Organization Certificate.
>
> 4. During the 1991, 1992, and 1993 summers, I purchased forty (40) cheese pizza pies, from Petitioners four (4) weeks, each summer, in my capacity as Camp Director.
>
> 5. Said pizzas were used for our organizational purposes and not for the benefit of any individual. We never paid any sales tax on these pizza purchases. (Petitioners' Exhibit 14.)

Investigator Caracappa spoke with Karen Blackburn between the two hearing days. Karen Blackburn confirmed that she bought 35 to 40 pizzas from Juniors fours times each summer and that they paid a reduced price of $7.00 per pie. She also told the investigator that she did not possess any further documentation regarding the amounts paid to Juniors.

25. With regard to the Helen Keller Services for the Blind petitioners introduced the affidavit of Vi Pollack which provided:

1. I am not a family member or a personal friend of any of the Petitioners.

2. I served as an Organizer at the Helen Keller Services for the Blind, located at 40 New York Avenue, Huntington, New York, during the 1991, 1992 and 1993 calendar years.

3. During the above stated years, the Helen Keller Services for the Blind had a valid New York Tax Exempt Organization Certificate.

4. During the 1991, 1992, and 1993 calendar years, I purchased two (2) cheese pizza pies, from the Petitioners each and every week, in my capacity as Organizer.

5. Said pizzas were used for our organizational purposes and not for the benefit of any individual. We never paid any sales tax on these pizza purchases. (Petitioners' Exhibit 15.)

Investigator Caracappa spoke with someone from the Helen Keller Services for the Blind. That person confirmed that two to three pizzas were purchased from Juniors each week during 1991, 1992 and 1993. That person also told the investigator there was no further documentation regarding the amounts paid to Juniors.

26. With regard to the American Legion Northport Post, petitioners introduced the affidavit of John Raggie which provided:

1. I am not a family member or a personal friend of any of the Petitioners.

2. I served as the Treasurer of the American Legion Northport Post, located on Woodside Street, Northport, New York, during the 1991, 1992 and 1993 calendar years.

3. During the above stated years, the American Legion Northport Post had a valid New York Tax Exempt Organization Certificate.

4. During the 1991, 1992, and 1993 calendar years, I purchased seven (7) seven pizza pies from the Petitioners each and every week of each year, in my capacity as Treasurer.

5. Said pizzas were used for our organizational purposes and not for the benefit of any individual. We never paid any sales tax on these pizza purchases. (Petitioners' Exhibit 18.)

Investigator Loesch placed several calls to the American Legion Northport Post, but did not get a response. Mark and Albert Salese testified that because the American Legion Northport Post paid their bill on a monthly basis they would have invoices for them. However, no invoices were introduced.

27. With regard to Huntington High School petitioners introduced the affidavit of John Paci which provided:

1. I am currently employed by Huntington High School and was employed as the Head Coach of its football team during the period of December 1, 1990 to November 30, 1993.

2. I am not a family member or a personal friend of any of the Petitioners.

3. My employer is a tax exempt entity.

4. During the period of December 1, 1990 to November 30, 1993, on behalf of Huntington High School, I purchased twenty (20) pizza pies for each of the twelve (12) weekly Friday film meetings of the football team during the football season from the Petitioner, Junior's Pizzeria. (Petitioners' Exhibit 9.)

Mark and Albert Salese testified that they did not in reality "sell" these pizzas, but rather that it was a type of barter system — they provided the pizzas and in return were given advertising in the football bulletin. A copy of the 1991 Huntington Blue Devil Football program was introduced. The back cover is a full-page advertisement for Juniors. Mark and Albert Salese testified that they did not have any documentation of this barter arrangement. Investigator

Caracappa spoke with John Paci by telephone on several occasions between the hearing dates. She testified that on the first occasion both John Paci and his wife indicated that the money to purchase the pizzas had come from their own pocket and they had even attempted to deduct this from their income tax, which they could not do. John Paci also agreed to sign a statement. When the investigator called back to inquire about the statement, John Paci told her that it was actually a barter system and that Juniors traded the pizza for advertisement in the football bulletin and possibly a calendar. The investigator also called Joseph Gianni, District Director of Physical Education and Athletics at Huntington, and he stated that it was some type of barter system and implied that it was not the high school providing the advertisement in return for the pizzas, but had to do with the funds from fund raising. According to John Paci's letter contained in the 1991 program, the Huntington Blue Devils did have a booster club.

SUMMARY OF THE PARTIES' POSITIONS

28. Petitioners admit that the Division's use of an indirect audit method was allowable under the circumstances because they did not maintain adequate books and records from which a complete audit could be conducted. However, petitioners, citing ***Matter of Spallina*** (Tax Appeals Tribunal, February 27, 1992), argue that the Division was required to select an audit method reasonably calculated to reflect the proper amount of tax due and that while it is petitioners' burden to prove that the audit was fundamentally flawed, once petitioners have proven the audit method selected was unreasonable they need not prove the exact amount of the assessment. Petitioners argue that the audit was unreasonable because: the prices used in the calculations were from the observation day and higher than the prices in effect during the audit period; the use of 34 dough balls per 50-pound bag of flour was mathematically unreasonable and 32 should be substituted; nontaxable uses of dough (producing their own complimentary

bread and hero rolls, dusting, personal usage and spoilage) were not taken into account; sales for resale (to Pomodoro and Pollo Pazzo restaurants, a lunch truck operator and a pizza truck operator at carnivals) were not taken into account; sales to tax exempt entities (the Y.M.C.A. of Long Island, the Helen Keller Services for the Blind, the American Legion Northport Post, the Northport Fire Department and Huntington High School) were not taken into account; the fact that petitioners did not operate Northport until 1992 was not taken into account; and the fact that petitioners' prices included sales tax should be taken into account. Petitioners have offered several alternative methods of computing the tax due for the audit period. One uses essentially the same calculations as were used in the audit, giving credit for those items listed above. The other is based solely on the observation test (i.e., not the observation test combined with the flour purchases) and also includes credit for the items listed above.

Petitioners, citing ***Jones v. Smith*** (120 Misc 2d 445, 466 NYS2d 175, ***affd on other grounds*** 64 NY2d 1003, 489 NYS2d 50), contend that the unsworn statement of Joseph David (Division's Exhibit R) should not be accepted into evidence since petitioners had no time to subpoena the witness and no opportunity to cross-examine the witness thereby impinging upon their constitutional rights to due process. Petitioners urge that if it is admitted it be given little weight due to the Division's having drafted the statement and Joseph David's having a limited ability to communicate in English.

29. The Division asserts that audits based on observation tests and audits based on third-party verification have been upheld as reasonable. Furthermore, the notice of determination issued by the Division is presumed to be correct and it is petitioners' burden to prove by clear and convincing evidence that the audit was unreasonable. The Division argues that petitioners have simply failed to meet this burden with regard to each of the claimed items. The Division

argues that petitioners' alternative methods of calculating tax should be rejected because it was petitioners' burden to prove the Division's audit unreasonable and that burden cannot be met by simply proposing an alternative method of calculating the tax due.

Regarding the statement of Joseph David the Division argues that hearsay evidence is admissible in administrative hearings and may constitute the substantial evidence required to support an administrative decision. Furthermore, the Division notes that much of petitioners' evidence is in the form of affidavits which are also hearsay evidence and that petitioners could have requested a continuance to subpoena Joseph David if they thought his presence was required.

Finally, the Division argues that petitioners have not demonstrated reasonable cause to cancel penalties.

CONCLUSIONS OF LAW

A. At the conclusion of the hearing in this matter the Division's Exhibit R, a signed but unsworn statement of Joseph David, had been marked as evidence but not accepted into the record. The parties were given an opportunity to comment on the admissibility of the unsworn statement in their briefs and a final decision on the issue was to be included in this determination.

The Division's Exhibit R is accepted into evidence. Hearsay consists of "the assertions of an extra judicial declarant, including those of the witness, when offered to prove the truth or falsity of the facts asserted" (Fisch, New York Evidence § 757 [2d ed]). As noted by the Division, much of the evidence presented in the current matter consists of hearsay including the affidavits submitted and the testimony of the witnesses presented by both parties as to conversations they had with people not present at the hearing. Hearsay evidence is admissible in administrative proceedings (***see,*** SAPA § 306[1]), and in particular in proceedings before the

Division of Tax Appeals (***see,*** 20 NYCRR 3000.15[d]; ***see also***, ***Matter of Orvis Co. v. Tax Appeals Tribunal***, 86 NY2d 165, 630 NYS2d 680 ***cert denied*** 516 US 989, 133 L Ed 2d 426; ***Matter of Spallina***, ***supra***). Furthermore, hearsay evidence may even form the basis of an administrative determination if it is relevant and probative (***see***, ***People ex rel. Vega v. Smith***, 66 NY2d 130,139, 495 NYS2d 332, 337; ***Matter of Flanagan v. State Tax Commn.***, 154 AD2d 758, 546 NYS2d 205)[10]. Finally, it is permissible to utilize an unsworn statement for the purpose of discrediting an affidavit (***see***, ***Matter of Orvis Co. v. Tax Appeals Tribunal***, ***supra***).

B. There is no dispute that the audit methodology utilized in this matter was an indirect methodology not based solely on the books and records of petitioners. In order for the Division to utilize an indirect methodology, it must show that it made an adequate request for books and records for the entire audit period (***see***, ***Matter of Christ Cella v. State Tax Commn.***, 102 AD2d 352, 477 NYS2d 858), and that it reviewed the records provided in order to determine that the records were inadequate for the purposes of conducting a complete audit (***see***, ***Matter of King Crab Rest. v. Chu***, 134 AD2d 51, 522 NYS2d 978). The original appointment letter sent by the Division to petitioners' accountant constituted an adequate request for books and records and covered the entire audit period currently at issue. The audit report and the auditor's testimony reflect that the records provided to the Division were reviewed and determined to be inadequate. Petitioners, through their testimony and their representative's closing argument, conceded that they did not maintain adequate books and records. Therefore, resort to an indirect audit method by the Division was proper.

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[10]Petitioners rely on ***Matter of Jones v. Smith*** (***supra***) for the principal that basing a determination on hearsay evidence in the form of an unsworn statement violates petitioners' constitutional rights. To the extent Jones enunciates such a rule it appears to have been overruled by ***People ex rel. Vega v. Smith*** (***supra)***.

C. Pursuant to Tax Law § 1132(c)(1), petitioners bear the burden of proving by clear and convincing evidence that the tax assessed was erroneous (***Matter of Rizzo v. Tax Appeals Tribunal***, 210 AD2d 748, 621 NYS 2d 115; ***Matter of Mobley v. Tax Appeals Tribunal***, 177 AD2d 797, 799, 576 NYS 2d 412, ***appeal dismissed*** 79 NY2d 978, 583 NYS2d 195; ***Matter of Surface Line Operators Fraternal Line Organization v. Tully***, 85 AD2d 858, 446 NYS2d 451). Furthermore, a presumption of correctness attaches to a notice issued by the Division, and the taxpayer must overcome this presumption (***see***, ***Matter of Suburban Carting Corporation***, Tax Appeals Tribunal, May 7, 1998, citing ***Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759, 431 NYS2d 174; ***Matter of Leogrande***, Tax Appeals Tribunal, July 18, 1991, ***confirmed*** 187 AD2d 768, 589 NYS2d 383, ***lv denied*** 81 NY2d 704, 595 NYS2d 398).

D. The next issue is whether petitioners have met their burden of proof in showing that the Division's determination of tax due based on an indirect audit method was unreasonable. Petitioners have not met their burden on this issue.

While the Division may resort to an estimated or indirect audit method to calculate sales tax due where a taxpayer has failed to present books and records adequate for the Division to conduct a detailed audit (***see***, ***Matter of Urban Liquors v. State Tax Commn.***, 90 AD2d 576, 456 NYS2d 138), the method chosen by the Division must be reasonably calculated to reflect the taxes due (***see***, ***Matter of W.T. Grant v. Joseph,*** 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869, 2 L Ed 2d 75; ***Matter of Ristorante Puglia, Ltd. v. Chu***, 102 AD2d 348, 478 NYS2d 91). The determination of whether the method chosen by the Division was reasonable is based on the information available to the Division at the time of the issuance of the notice (***see***, ***Matter of Continental Arms Corp. v. State Tax Commn.***, 72 NY2d 976, 534 NYS 2d 362; ***Matter of Northern States Contracting Co.***, Tax Appeals Tribunal, February 6, 1992).

In the present case the Division was presented with limited information from petitioners. Petitioners originally provided some purchase invoices from Lisanti Foods, Inc. and Vesuvio Foods, a "daybook" (the numbers were for all three stores grouped together with a three-day total and then computed on a weekly basis) and worksheets prepared by their accountant. Upon review of the invoices the Division determined that the purchase invoices provided were significantly higher than those recorded in petitioners' books. When petitioners were asked to provide authorization to Lisanti Foods, Inc. to release invoices, they simply refused, thus requiring the Division to subpoena the records. Utilizing the subpoenaed invoices, the Division based its audit on a combination of flour purchases and an observation test to determine the percentage of sales attributable to meals and soda and the average selling price of the dough products. There was a one-day observation at each of petitioners' three locations. An audit based on a combination of purchases and observations has been upheld as reasonable (***see***, ***Matter of Nusco***, Tax Appeals Tribunal, March 31, 1994).

Petitioners argue that the audit was unreasonable because the auditor ignored the nontaxable uses of flour, although she was aware of these uses. This is based on petitioners' assertion that having weighed the dough balls and known that 32 to 34 was the correct amount of dough balls per 50-pound bag of flour, the auditor could not contend that dusting, personal use and spoilage were accounted for by using 34 dough balls per bag in her calculations. At the time of the audit petitioners presented the Division with no documentation regarding the use of any amounts for dusting, personal use or spoilage. The only information provided by petitioners was worksheets prepared by their accountant claiming certain amounts of such usage per week. It was reasonable for the Division to utilize only documentation it had. Furthermore, petitioners cannot merely assert their own estimates (***see***, ***Matter of Rizzo***, Tax Appeals Tribunal, May 13, 1993).

Petitioners also claim that the audit was unreasonable because the Division used inflated prices (i.e., those prices on the menus at the time of the observations which petitioners claim were higher than the prices during the audit period). Petitioners did not provide the auditor at the time of the audit, nor have they yet provided, any evidence regarding what the prices were during the audit period. Again the Division had no information available to it on which to base a price adjustment (***see***, ***Matter of Rizzo***, ***supra***).

Petitioners argue the audit was unreasonable because the auditor did not take into account complimentary uses of dough products and sales for resale. Again, all the Division received from petitioners on these points were the worksheets from petitioners' accountant with claimed amounts due (***see***, ***Matter of Rizzo***, ***supra***; ***Matter of Pizza Works***, Tax Appeals Tribunal, March 21, 1991; ***Matter of Albanese Ready Mix***, Tax Appeals Tribunal, June 15, 1989).

With regard to sales to exempt organizations, at the time of the audit petitioners did not even assert such sales, so it is hard to comprehend how the audit could be considered unreasonable on this basis.

Petitioners also argue that it was unreasonable for the auditor to include a time period for Northport when petitioners did not operate that location. Petitioners have not pointed to any evidence available to the auditor at the time of the audit that would have proven this point. In short, the audit was entirely reasonable based on the information available to auditor at the time of the audit (***see***, ***Matter of Continental Arms Corp. v. State Tax Commn.***, ***supra***; ***Matter of Northern States Contracting Co.***, ***supra***).

Finally, petitioners have offered several alternative methods of computing the tax due for the audit period. The Division argues that these alternatives should not be considered. With regard to the method that uses essentially the same calculations as were used in the audit, only

giving credit for certain items, this method is merely a numerical expression of petitioners' arguments that are addressed in this determination. To the extent that the other method, based solely on the observation test (i.e., not the observation test combined with the flour purchases) impliedly argues that use of the combined test is unreasonable and use of an observation test only is required, such argument is rejected (***see***, ***Matter of Nusco***, ***supra***).

E. The final issue is whether petitioners are entitled to any adjustments in the audit figures based upon the evidence they presented at hearing. As discussed in Conclusion of Law "C", petitioners in this matter bear the burden of proof. Furthermore, Tax Law § 1132(c)(1) creates the presumption that all of petitioners' receipts were taxable unless petitioners can prove otherwise by clear and convincing evidence. This is not a case where petitioners have proven the audit methodology unreasonable and need not prove the amount of any adjustments (***see***, ***Matter of Bernstein-on-Essex St.***, Tax Appeals Tribunal, December 3, 1992). The audit methodology in this matter was reasonable based on the information provided to the Division at the time of the audit, and therefore petitioners must prove the amount of any adjustment to the audit results.

F. The first question to be addressed is whether the Division's use of 34 dough balls per 50-pound bag of flour was correct, or whether petitioners have proven that 32 dough balls per bag should have been utilized. It has been determined that petitioners' dough balls weigh two and one-quarter to two and one-half pounds and the Sicilian dough balls weigh three and one-quarter to three and one-half pounds. While the Division continues to maintain that this is simply in contravention of the auditor's experience (i.e., approximately 50 dough balls per bag or 1.6 pounds per dough ball) the investigator went back to each location to weigh the dough balls. The investigator confirmed that the dough balls weighed were consistent with petitioners' assertion that its dough balls weighed two and one-quarter to two and one-half pounds and the Sicilian

dough balls weigh three and one-quarter to three and one-half pounds. The visit of the investigator was, at least at the first location, unannounced. The Division argues that it was the petitioners who selected which dough balls to weigh, implying that there might have been other size dough balls that were not weighed. However, the investigator testified that she did not ask to select the dough balls. Also, the Division argues that it is not possible to use two size dough balls for all dough products. However, the testimony of Mark and Albert Salese as to how the dough balls were divided to make the other dough products was a valid explanation.

It was agreed by the parties, through the testimony of their respective witnesses, that the weight of a 50-pound bag of flour after adding the other ingredients necessary for making dough, is approximately 75 to 80 pounds. Using the average weights 2.375 and 3.375 and the split of 28 regular pies and 4 Sicilian pies per 50-pound bag of flour, the result is 80 pounds of dough. Petitioners calculations simply substitute 3.125 for the average weight of the Sicilian dough balls, and their result is 75.5 pounds of dough. Petitioners, while testifying that they get 32 dough balls per bag of flour on a consistent basis, have shown no reason why the 34 dough balls per bag is unreasonable. It is based on numbers petitioners agree with, both the weight of the dough balls and the total dough per bag, and the use of 75 to 80 pounds as an approximation of the weight of a 50-pound bag of flour after being made into dough. Furthermore, petitioners' own accountant originally presented the Division with the number of 34 dough balls per bag. Petitioners have not proven that the use of 34 dough balls per bag was incorrect.

G. Having determined that 34 dough balls per 50-pound bag of flour was the correct number, such number cannot be said to include an allowance for uses of the dough other than taxable dough product sales. While the auditor may have intended the 34 dough ball figure to be a type of settlement used to reach an agreed-upon audit, it is clear that was not the intention of

petitioners. The calculations provided to the Division by petitioners' accountant at the time of the audit conference indicate that it was petitioners' position that there were 34 dough balls per bag of flour and that petitioners were then entitled to deductions for dusting, personal use and spoilage.

Mark and Albert Salese's testimony that one 50-pound bag of flour per week per store was utilized for the purpose of dusting or peel was consistent, both one with the other and with their position since the audit, and was credible. While the Division's auditor did not agree on the amount utilized, she did testify as to her understanding of the process of dusting. On this basis it is determined that petitioners are entitled to credit for one 50-pound bag of flour per week per store for dusting (***see***, ***Matter of Spallina***, ***supra***).

With regard to the issues of personal use and spoilage it is believable that both of these existed. However, petitioners' attempts to quantify the amount of flour use attributable to these purposes falls short of clear and convincing proof. The testimony explained that, with regard to spoilage, sometimes leftovers were given away or taken by the family. The family took not only cooked products but also raw dough. However, even Mark and Albert Salese were unsure that this amounted to one 50-pound bag of flour per week per store. From the testimony on this point it is clear that Mark and Albert Salese were simply guessing, and providing their own estimate does not meet their burden of proof (***see***, ***Matter of Pizza Works***, ***supra***).

H. The next question is whether petitioners have proven that complimentary bread was given with dinners and if so the amount of such bread. The affidavits of two of petitioners' customers indicate that they received complimentary bread with the dinners they purchased at Juniors during the audit period. Mark and Albert Salese testified that they had always made

complimentary bread from dough balls and that one dough ball made enough bread for two to four (or an average of three) dinners.

In response the auditor first testified that high gluten flour (the type used for making pizza dough) could not be used to make bread, which was refuted when petitioners introduced a commercial bread wrapper listing high gluten flour as an ingredient. The auditor further testified that complimentary bread is given with dinners only in a more family type restaurant not a location that was strictly a pizzeria. However, her testimony on which classification petitioners' establishments fit into was confusing. Finally, the investigator was able to testify only that she did not remember whether bread was given with the meals. Based on Mark and Albert Salese's testimony as supported by the customer affidavits, petitioners are to be given credit for three servings of complementary bread per dough ball, the number of dinners served to be determined by the observation day (***see***, ***Matter of Spallina***, ***supra***).

I. The next question is whether petitioners are to be given credit for making their own hero rolls. Petitioners have not met their burden of proof on this issue. Mark and Albert Salese's testimony first indicates that they made their own hero rolls and ordered rolls for six-foot long subs only on special occasions due to volume. Mark and Albert Salese's testimony then indicates that: they now purchase rolls, but that is a change from their practice of making rolls during the audit period; they sometimes ordered hero rolls; they purchased hero rolls from Joseph David only during the audit period, and only on special or rare occasions; and that they ordered from Joseph David on a weekly rather than daily basis. The only evidence presented on this issue is the testimony of Mark and Albert Salese, and, unlike their testimony on the complementary bread issue, their testimony on this issue lacked exactness and clarity and seemed confused.

The Division introduced the statement described in Finding of Fact "14"and Conclusion of Law "A" from Joseph David. Joseph David's statement indicates that up until six months prior to signing the statement he sold Juniors a total of 250 hero rolls a week plus 120 club rolls for Cow Harbor Day. It is unclear why the Division did not attempt to get a sworn statement, or the extent of Joseph David's comprehension of the English language. However, Joseph David's signed statement does indicate that he did sell heroes to petitioners on a regular basis, especially in light of Mark and Albert Salese somewhat confused testimony on this issue. Petitioners have not met their burden of proof in showing that they made all the rolls for their hero sandwiches, or what part they did make, or how many bags of dough would be involved. Therefore, petitioners are not entitled to an adjustment for hero rolls.

J. Petitioners also contend that they are entitled to credit for sales of 30 dough balls a day or 210 dough balls a week to Eric Machado. In his affidavit Mr. Machado states that he is and was during the audit period employed as the manager of Pollo Pazzo at 364 New York Avenue in Huntington and Pomodoro Restaurant at 62 Stewart Avenue in Huntington. He further states that he purchased 30 dough balls a day from Juniors for these two restaurants for bread products. Mark and Albert Salese testified that these restaurants were owned by Fabio Machado, Eric Machado's father. They also testified that Fabio Machado owned about four restaurants during the audit period and now owned approximately eight restaurants, that Fabio Machado was not involved with the day-to-day operations of the restaurants, and that they always dealt with Eric Machado. Mark and Albert Salese testified that 20 dough balls per day were for Pollo Pazzo, a sandwich shop and were used for making focaccia bread for chicken sandwiches. The other 10 were used for complimentary bread at Pomodoro Restaurant.

During the time between the two hearing days a Division investigator contacted Fabio Machado together with Dean Coyes and Juan Gomez, who were affiliated with Mr. Machado. All three confirmed that dough balls were purchased from Juniors during the audit period, but that the number of dough balls was 30 dough balls per week, not per day. None of the three stated that they were directly involved with the purchase of the dough balls and Fabio Machado stated that he was not at the restaurant much. The investigator stated that she did not ask about Pollo Pazzo, only Pomodoro Restaurant. The Suffolk County Food Establishment permit introduced for Pollo Pazzo indicates that Pollo Pazzo was not in operation prior to 1994, as do the Division's sales tax records. Contrary to petitioners' assertions, such official government documents are not "self-serving" records, but documentary evidence regarding the existence of Pollo Pazzo. Petitioners, other than raising questions as to whether the sales taxes and food permits could have been filed for years prior to 1994 in combination with Pomodoro Restaurant, have submitted no evidence contradicting the documentation that Pollo Pazzo was not even in existence at the time of the audit period. Furthermore, petitioners did not assert that Pollo Pazzo had ever been at a location other than 366 New York Avenue, and the Suffolk County Food Establishment Permit indicates that Pollo Pazzo was established in 1994 at a location that was vacant but had previously been a shoe store. On this basis petitioners are not entitled to any adjustment for sales to Pollo Pazzo.

Petitioners are, however, entitled to an adjustment for sales to Pomodoro Restaurant. Eric Machado's affidavit, the testimony of Mark and Albert Salese and the Division's confirmation that dough balls were sold to Pomodoro Restaurant is clear and convincing evidence that such dough balls were sold. Furthermore, the affirmation of Eric Machado and the testimony of the Saleses are accepted with regard to the number of dough balls sold since these were the people

directly involved in the transactions. An adjustment, in the amount of 10 dough balls per day or 70 dough balls per week, shall be made to indicate the sales of dough balls to Pomodoro Restaurant.

K. Petitioners are not entitled to an adjustment for sales to Ian Mulligan (or Milligan) who petitioners assert purchased dough balls to make pizzas to sell in Newton & Sons carnivals every weekend from Memorial Day to Labor Day. Petitioners' only evidence on this point is their own testimony, part of which is that they do not have an affidavit from Ian Mulligan because he refused to sign one. The Division introduced a statement from Michael Newton of the carnival stating that Ian Milligan was not employed by it and to the best of his recollection Ian Milligan sold pizza at the carnivals twice in 1991 and three or four times in 1992 and 1993. This does not coincide with petitioners' recollection that sales were made every weekend during the summer. Petitioners have not met their burden of proving these sales.

L. Petitioners are not entitled to credit for sales of pizzas to Steve Hamby who operated a lunch truck. As pointed out by the Division, Tax Law § 1105(d)(3) does not allow for an exemption from sales tax, as a sale for resale, food sold in a heated state. Since the pizzas were sold in a heated state petitioners are simply not entitled to the credit pursuant to law.

M. The next question is whether petitioners are entitled to a credit for some or all of their sales to exempt organizations. Tax Law § 1116 exempts from sales and use taxes sales to exempt organizations. The Division has determined that the Northport Fire Department, the Y.M.C.A. of Long Island, the Helen Keller Services for the Blind and the American Legion Northport Post are exempt organizations. The only question remaining is whether petitioners have proven the amount of any sales to these organizations.

N. The Northport Fire Department is an exempt organization, and as noted by the Division, petitioners are entitled to the sales to the Northport Fire Department which were confirmed by the invoices submitted as Petitioners' Exhibit 16. Petitioners therefore are entitled to credit for exempt sales to the Northport Fire Department in the amount of $1,701.50.

No credit can however be given for the carnival purchases which do not appear to be included in such invoices. The list of purchases provided by the Fire Department shows certain purchases made by the fair committee. These purchases are inconsistent with the fair purchases outlined in the fair chairman's affidavit. Therefore, petitioners have not met their burden of proof on the fair committee purchases.

O. Petitioners are entitled to a credit for the sales to the Y.M.C.A. of Long Island, the Helen Keller Services for the Blind and the American Legion Northport Post. The affidavits presented are detailed regarding the amount of such purchases, and, while not based on a review of any records, these are credible because of the frequency and consistency of the purchases.

The Division cites ***Matter of On the Rox Liquors, Ltd. v. State Tax Commission*** (124 AD2d 402, 507 NYS2d 503 ***lv denied*** 69 NY2d 603, 512 NYS2d 1026) in support of its assertion that without documentation such as invoices, canceled checks, etc., the purchases cannot be allowed. In ***Matter of On the Rox*** petitioner was unable to provide any documentation of purchases.[11] While the Division interprets this case to mean that documentation in a form such as the invoices from the Northport Fire Department discussed above are what is required, it points to no case to support its position that the affidavits submitted by petitioner are insufficient by law. In this case the exempt organizations have provided documentation in the form of

[11]Petitioner had actually been granted a modification of the initial assessment by the Division where substantiation of purchases from the exempt organizations was provided.

affidavits. Furthermore, in two of these cases, the investigator even contacted the affiants who confirmed the information contained in the affidavits.

Based on their affidavits these sales are allowed as follows: the Y.M.C.A. of Long Island — 40 cheese pizzas a week for 4 weeks for each of the summers of the audit period; the Helen Keller Services for the Blind — 2 cheese pizzas a week for every week of the audit period; and the American Legion Northport Post — 7 pizzas a week for every week of the audit period.

P. Petitioners have not met their burden of proof regarding the sales to Huntington High School. The affidavit of Mr. John Paci provides that he purchased 20 pizza pies each Friday for 12 Fridays of the football season each year. To begin with it is not possible to quantify this as there is no definition of the football season. Second, Mark and Albert Salese's own testimony contradicts the affidavit in that Mark and Albert Salese are claiming the pizzas were not purchased but were bartered for advertisements. Third, the Division argues that petitioners have not shown these pizzas were paid for (either with money or for barter) by the actual tax exempt organization and not a booster club or some other taxable group. There did exist at Huntington High School a booster club. This, combined with the discussions between the Division's investigator and John Paci and Joseph Gianni between the two hearing dates, leaves questions regarding this evidence. The evidence presented on these sales is insufficient to meet petitioners' burden of proof. (***See***, ***Matter of On the Rox Liquors, Ltd. v. State Tax Commission***, ***supra***.)

Q. Mark and Albert Salese contend that they did not actually start operations in Northport until 1992 which they describe as after the holidays, January, February or March at different times in their testimony. The only documentary evidence on this issue is the lease signed in November of 1991 and the bills addressed to Mark and Al Salese from Lisanti Foods, Inc. for November and December of 1991. Mark and Albert Salese contend that they were not

operating the store but were required to sign the lease and guarantee payment of their brothers' bills in order for the business to remain open and operated by their brothers until they took over. However, in that Mark and Albert Salese cannot even remember exactly when they took over the operation of Northport, the evidence showing they took over in November 1991 controls. The Division, while never actually conceding that the period December 1990 through May of 1991 should be canceled, contends that petitioners took over in June of 1992. As evidence of this they point out that the lease signed in November of 1991 was for the period June of 1991 through May of 1992. The Division also points to a food permit they assert was for the same period. However, as discussed in Finding of Fact "18", it was actually the brother who signed for the period in question and petitioner Frank A. Salese signed for the period June of 1992 to May of 1993. The documents submitted by the Division were actually bills for the following year and not permits for the previous year. The period named in the lease does not overcome the fact that the lease was signed in November 1991 and there are no invoices from Lisanti Foods, Inc. prior to November. It is determined that petitioners took over the operation of Northport in November of 1991. Based on this evidence the tax contained in the notice attributable to Northport for the period December of 1990 through October of 1991 is canceled.

R. The last remaining question is whether petitioners included sales tax in the prices listed on their menus and charged to their customers. Mark and Albert Salese testified that sales tax was included in their prices and had always been so. The audit report and supporting testimony was that there were no signs posted in petitioners' establishments that indicated sales tax was included in the prices. The menus in evidence do not state that sales tax was included. On the observation days sometimes sales tax was charged separately and sometimes not. Mark

and Albert Salese testified that guest checks, while not retained, were utilized for ordering purposes and were given to the customers as bills.

Tax Law § 1132 (a) requires that when a vendor gives a customer any type of receipt, sales tax shall be separately stated on that receipt (***see also***, 20 NYCRR 532.1[b]). Since Mark and Albert Salese testified that guest checks were given to customers as bills, petitioners were required by law to separately state the tax. Furthermore, even if no guest checks were given to the customers, there are certain requirements that must be met when using unit pricing (i.e., the practice of including sales tax in the price). In particular, in order for customers to be aware that sales tax was included in the price of the product, petitioners were required to "visibly display, to all customers a placard stating that the prices of all taxable items include sales tax" (20 NYCRR 532.1[4]). There was no notification of any type at any of petitioners' establishments. Petitioners cannot now have their tax calculated on the basis that sales tax was included in the prices charged when if that was the case petitioners were clearly acting in contravention of the law.

S. Petitioners have not through the course of these proceedings made any argument regarding reasonable cause for the cancellation of penalties. Therefore, while mentioned in the Division's brief it is not an issue in this case and will not be addressed in this determination.

T. In summary, the audit methodology employed by the Division was reasonable based on the information provided to it at the time of the audit. However, based on the further information provided at hearing petitioners are entitled to adjustments for flour used in dusting or peel, flour used for complimentary bread, dough ball sales to Pomodoro Restaurant, exempt sales to the Northport Fire Department, the Y.M.C.A. of Long Island, the Helen Keller Services for the Blind and the American Legion Northport Post, and ownership of Northport commencing in November of 1991.

U. The petition is granted to the extent set forth in Conclusions of Law "G", "H", "J", "N", "O", and "Q", but is in all other respects denied. The Notice of Determination dated May 12, 1995, as modified by Conclusions of Law "G", "H", "J", "N", "O", and "Q", and the payments under amnesty set forth in Finding of Fact "11", is sustained.

DATED: Troy, New York
July 23, 1998

/s/ *Roberta Moseley Nero*
ADMINISTRATIVE LAW JUDGE