STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
217 JERICHO CAR WASH, INC.	:	SMALL CLAIMS DETERMINATION
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1999 through February 28, 2002.	:	DTA NO. 820831

Petitioner, 217 Jericho Car Wash, Inc., c/o FSC Enterprises, Inc., 5586 Broadway, 3rd Floor, Bronx, New York 10463-5519, 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 June 1, 1999 through February 28, 2002.

A small claims hearing was held before Frank W. Barrie, Presiding Officer, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on January 25, 2007 at 10:45 A.M., with all briefs to be submitted by June 8, 2007, which date began the three-month period for the issuance of this determination. Petitioner appeared by Costas C. Kreatsoulas, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Pamela Wolf [at hearing], Robert A. Maslyn, Esq. [on brief]).

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioner has shown error in either the audit method or result.

II. Whether penalties were properly imposed.

FINDINGS OF FACT

1. Petitioner, 217 Jericho Car Wash, Inc., doing business as Elite Car Wash, operated a car wash on Long Island located at 217 W. Jericho Turnpike in Huntington Station. An S corporation, petitioner's stock was owned by five individuals with varying percentage interests: Amnon Gilad, 30%; John Rusch, 25%; Bernard Uoziel, 22.5%; Salvatore Ferdico, 15%; and Ratzon Kochavi, 7.5%. Mr. Rusch, questioned on direct examination by his co-owner, attorney Bernard Uoziel, testified on behalf of petitioner.

2. During the audit period at issue, consisting of 11 sales tax quarters (which equates to a period of two years and nine months), petitioner reported on its sales tax returns total gross sales of $483,973.00, and reported the same amount of $483,973.00 as its total taxable sales.

3. John Prehm, an investigator employed by the Division of Taxation ("Division"), prepared a report after a field visit to the car wash on Thursday, February 7, 2002, which noted that petitioner had hours of operation from 7:30 A.M. to 6:00 P.M., seven days a week. The investigator observed that prices were posted in two separate locations, on a fence and on a wall. According to the investigator's report, the prices listed on the wall specifically noted that they were "plus tax" and did not have tax included. Included on the list of prices on the wall were a range of more expensive services including "interior shampoo" at $64.95, "hand wax" at $34.95, "engine steam clean" at $29.95, "upholstery only" at $29.95, "carpets only" at $29.95, "full leather" at $34.95, "elite simonize" at $24.95 and detailing services of "complete exterior" at $64.95 and a "gold package" at $99.00. The investigator also noted that the car wash had a retail store which sold "car, van and truck accessories" and bottled soda. The auditor who performed the observation test on October 25, 2002, as detailed in Finding of Fact "6", noted that the retail store sold "car accessory items, fresheners, sunglasses, etc."

4. Approximately three months after the investigator's field visit to the car wash, a sales tax audit of petitioner was assigned to Robert Hoffman, an auditor with the Division's Suffolk District Office. Although requested by the auditor, petitioner did not produce register tapes or a daybook listing sales, which according to the auditor's report were, in fact, "not maintained" by petitioner. The auditor also determined that petitioner's "sales records did not allow the opportunity to trace any transaction back to the original source or forward to a final total." Further, the auditor discovered that petitioner's gross sales were not in substantial agreement with the sales reported on petitioner's Federal income tax returns or State sales tax returns. In addition, petitioner's bank deposits "were not in substantial agreement with books and records."

5. Due to the inadequacy of petitioner's records, the auditor used a combination of an observation test performed on Friday, October 25, 2002, and an analysis of petitioner's water usage.

6. The observation test performed on October 25, 2002 was conducted in a thorough and professional fashion by the auditor and Linda Caracappa, an investigator. Based upon the observation test, the Division determined that the average taxable sale was $7.63.

7. The auditor obtained information from the South Huntington Water District showing that petitioner purchased 4,964,000 gallons of water during the audit period. To determine the number of gallons of water used per each car wash, the Division used an engineering study from a prior audit prepared by Jarash Engineering, PC. This report determined that a certain undisclosed[1] car wash, which was the subject of the prior audit and which was *not* petitioner's car

[1] Secrecy provisions of the Tax Law prohibited the disclosure of such details.

wash business, used 32.25 gallons of water for each car wash.[2] This report also noted that a car wash uses water (i) to operate washing machines to launder towels used in the business, with an average water usage per car of 2.9 gallons; (ii) to flush toilets, with an average water usage per car of 0.333 gallons and (iii) to power wash the driveway and prep area, with an average per car consumption of 1 gallon. The engineer summed up the amount per car of such additional water usage as 4.233 gallons. When added to the 32.25 gallons of water for each car wash, the engineer computed "water consumption per car" of 36.483 gallons.

8. The auditor computed "audited car washes" of 153,922.48, by dividing the 4,964,000 gallons of water purchased by petitioner during the audit period by "average water usage per car" of 36.483 based on the engineering study by Jarash Engineering, PC. He then multiplied "audited car washes" of 153,922.48 by the audited average sale per car wash of $7.63 based upon the observation test, to compute audited taxable sales totaling $1,175,024.36. Sales tax of $97,667.98 was calculated as due on such audited taxable sales, with additional sales tax due of $57,411.98. Petitioner had remitted sales tax during the audit period of $40,256.00 on its reported total taxable sales of $483,973.00. In sum, the auditor determined that petitioner had unreported taxable sales of $691,051.30, representing approximately 59% of the audited taxable sales of $1,175,024.36.

9. The Division issued a Statement of Proposed Audit Changes dated September 16, 2003 asserting tax due of $57,411.97 plus penalty and interest based upon its audit. Subsequently, the Division issued a Notice of Determination dated January 26, 2004 asserting tax due of

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[2] The engineer utilized the following methodology. Ten customer cars were used to conduct the test varying from a Toyota Camry to a Jeep Cherokee. Before starting the test, a water meter reading was taken. The ten cars were then run through the car wash. After the test, the water meter reading was taken again. The total consumption of water for the ten cars was divided by 10 to determine the 32.25 gallons per car.

$57,411.97 plus penalty and interest. Penalties were imposed for underpayment of tax, including the omnibus penalty, based upon petitioner's underreporting of sales tax due by more than 25 percent.

10. The length of a car wash tunnel affects the amount of water usage. The report relied upon by the Division did not note the length of the unrelated car wash tunnel analyzed by the engineer. The report also did not detail the type of equipment utilized in the car wash analyzed. In contrast, petitioner's car wash has equipment supplied by Econocraft Worldwide Mfg., Inc. and includes one prerinse arch, one foam arch, one pair of side brushes, one pair of pencil tire brushes, one rinse arch, consisting of two final rinses, one wax rinse and one polish wax rinse, two pressure guns, two criss-cross curtains, one bumper blaster and one polish wax arch with one top brush and two side brushes. Shlomo Malki, the president of petitioner's equipment supplier, estimated, in his letter dated December 19, 2006 to John Rusch, that given the equipment it sold to petitioner, "with a conveyor running at its maximum capacity of 75 cars per hour," an average of approximately 42 gallons per vehicle would be utilized. In addition, John Rusch, who was responsible for petitioner's operation of the car wash and who has managed 4 different car washes in the past 5 years, noted that petitioner's conveyer normally runs at 40 cars per hour not the maximum 75 cars per hour. He estimated that at this slower speed, 75% more water would be used per vehicle which would equate to 73.5 gallons per car instead of 42 gallons per vehicle as indicated by Mr. Malki in his letter. He also noted that the bumper blaster equipment uses "lots of water" and the engineer's report relied upon by the Division did not note whether the unrelated car wash had a bumper blaster.

CONCLUSIONS OF LAW

A. Every person required to collect sales tax must maintain records sufficient to verify all transactions, in a manner suitable to determine the correct amount of tax due (Tax Law § 1135[a][1]). As noted in the findings of fact, petitioner failed to produce records sufficient to verify its sales. The pivotal fact in this matter is that the taxable sales reported by petitioner on its sales tax returns were not supported by any records available for audit and verification. Even at the hearing, the only documents introduced into the record by petitioner consisted of the projection by the Division's auditor of the results from his observation test showing "audited taxable sales" of $659,472.34 if such test were used as the *sole* basis for calculating audited sales, and the letter from petitioner's supplier of equipment as detailed in Finding of Fact "10". Consequently, the Division's right to resort to an estimate of petitioner's sales, as long as it selected an audit method reasonably calculated to reflect the sales and use taxes due, remains unassailable (***see, Matter of Rincon***, Tax Appeals Tribunal, October 9, 2003).

B. Given the nature of the business conducted by a car wash, an observation test of a single day's business to estimate sales over an audit period consisting of three years has many drawbacks. Weather conditions greatly affect sales. In the matter at hand, the day the observation test was conducted was overcast which would cause a decrease in the number of car washes while the fact that it was conducted on a Friday would tend to increase sales since Friday is typically a busier day for a car wash business with its customers desiring clean cars for the weekend. Consequently, it was reasonable for the Division to formulate a different methodology for estimating petitioner's sales than relying on an observation test, and the auditor's decision to calculate sales by analyzing petitioner's water consumption represented a reasonable methodology for estimating the number of car washes performed. Of course, such reasonable

methodology for estimating petitioner's sales was *imprecise*. Furthermore, the fact that the auditor utilized an engineering report for an unrelated car wash is clearly not preferable to the use of an engineering report especially prepared for petitioner's operation. Nonetheless, the use of the engineering report from an earlier audit of an undisclosed car wash does not rise to the level of arbitrariness requiring the cancellation of the assessment. It is important to recognize that any imprecision in the audit results was the consequence of petitioner's failure to maintain adequate books and records as required by Tax Law § 1135(a)(1), and such imprecision must be borne by the taxpayer (***see, Matter of Markowitz v. State Tax Commn***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454).

C. The analysis therefore shifts to whether petitioner has shown, despite the conclusion that the audit methodology in the first instance was reasonable, that "the amount of tax assessed was erroneous" (***Matter of Pay TV of Greater New York, Inc.,*** Tax Appeals Tribunal, July 14, 1994). As detailed in Finding of Fact "10", petitioner has introduced evidence to establish that an average of approximately 42 gallons of water per vehicle would be utilized if the conveyer was moving at its maximum speed. However, the conclusory testimony of Mr. Rusch, without more, is insufficient to conclude that this amount of water per vehicle should be increased by 75% based upon the conveyer running normally at 40 cars per hour instead of the maximum 75 cars per hour. As noted in Footnote "2", the engineer's methodology was simple enough to duplicate on petitioner's own car wash operation if petitioner took the initiative to do so. Nonetheless, based upon the evidence from petitioner's equipment supplier, the auditor is directed to recompute her estimate of petitioner's sales by utilizing 46.233 gallons per vehicle (42 gallons plus the amount per car of additional water usage of 4.233, to account for the

additional uses of water as detailed in Finding of Fact "7", instead of water consumption per car of 36.483 which she used at audit).

D. Petitioner has contended that the average taxable sale price of $7.63 computed by the auditor based upon the observation test, as noted in Finding of Fact "6", was unreasonable since such calculation included the cost of a car detailing service provided on the day of the observation. Such contention is rejected since petitioner provided a range of pricey services, and on any given day it might have revenue from such services. Further, petitioner's contention that the auditor failed to consider that some of its prices included sales tax is rejected. As noted in Finding of Fact "3", the prices listed on the wall specifically noted that they were "plus tax" and did not have tax included (***cf., Matter of Auriemma***, Tax Appeals Tribunal, September 17, 1992 [wherein the Tribunal noted that the taxpayer had established that on a placard listing its ice cream prices it made its customers "aware of the inclusion of sales tax in the sales price" so that "the prices posted should not have been further inflated [by the auditor] to account for additional sales tax"]). It is also observed that the auditor's estimate of petitioner's taxable sales did not include sales of tangible personal property in petitioner's retail store, as noted in Finding of Fact "3", which was to petitioner's advantage.

E. Petitioner has not established that its failure to pay tax was due to reasonable cause and not due to willful neglect. In the words of the Tax Appeals Tribunal, in establishing reasonable cause, the taxpayer faces an "onerous task" (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). The Tribunal explained why the task is onerous as follows:

> By first requiring the imposition of penalties (rather than merely allowing them at the Commissioner's discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citations omitted (***Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal, January 16, 1992).

It is noted that basing one's tax returns *not on actual sales records* indicates "at the very least, a lack of due care" (***Matter of Himed Deli Corp.***, Tax Appeals Tribunal, March 30, 2000). The Tax Appeals Tribunal has noted on many occasions that in considering abatement of penalty the most important factor to be taken into account is the taxpayer's efforts to comply with its obligations under the Tax Law (***e.g., Matter of Northern States Contracting***, Tax Appeals Tribunal, February 6, 1992). In short, merely *estimating* the amount of tax due on tax returns, which appears to be the case here, does not provide a basis to abate penalties (***see, Matter of A & A Service Station, Inc.***, Tax Appeals Tribunal, February 5, 2004). Furthermore, even with the reduction as noted above, petitioner's underreporting of taxable sales will remain in excess of 25%, and therefore the omnibus penalty is still properly imposed.

F. The petition of Jericho Car Wash, Inc. is granted to the extent indicated in Conclusion of Law "C", and the Notice of Determination dated January 26, 2004 is to be modified to so conform, but, in all other respects, is denied.

DATED: Troy, New York
September 6, 2007

/s/ Frank W. Barrie
PRESIDING OFFICER