

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
<b>MING MOON KITCHEN, LLC</b>	:	
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period March 1, 2002 through August 31, 2003.	:	SMALL CLAIMS
	:	DETERMINATION
	:	DTA NOS. 820898
	:	AND 820987
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In the Matter of the Petition	:	
of	:	
<b>WU AI ZHU D/B/A NEW MING MOON II</b>	:	
for Revision of a Determination or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period September 1, 2000 through February 28,	:	
2002.	:	
	:	

Petitioner Ming Moon Kitchen, LLC, c/o William K. Chan, 31-33A Market Street, New York, New York 10002, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2002 through August 31, 2003.

Petitioner, Wu Ai Zhu d/b/a New Ming Moon II, c/o William K. Chan, 31-33A Market Street, New York, New York 10002, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 2000 through February 28, 2002.

A consolidated 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 24, 2007, with all briefs to be submitted by July 2, 2007, which date began the three-month period for the issuance of this determination. Petitioners appeared by William K. Chan, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Cynthia Thomas [at hearing], Osborne K. Jack, Esq. [on brief]).

### ***ISSUES***

I. Whether the one-day observation test, conducted by the Division of Taxation, of an upstate Chinese restaurant in a small college town, was reasonable or whether petitioners have shown error in either the audit method or result.

II. Whether penalties were properly imposed.

### ***FINDINGS OF FACT***

1. Petitioner Wu Ai Zhu d/b/a New Ming Moon II operated a Chinese restaurant known as Ming Moon Restaurant in the college town of Delhi in upstate Delaware County during the period September 1, 2000 through February 28, 2002. Wu Ai Zhu and her husband, Dong Rui Liang, formed a limited liability corporation known as petitioner Ming Moon Kitchen, LLC, which continued the operation of the restaurant, in the same format with the same menu, for the later period at issue, March 1, 2002 through August 31, 2003. Wu Ai Zhu and Dong Rui Liang did not have any employees, although their son would assist them in the operation of the restaurant especially during summers when he was home from college.

2. Petitioners' Chinese restaurant was located in a down-on-its-heels Ames Plaza, with the Ames store and Grand Union supermarket shuttered. Other active businesses in the plaza consisted of a laundromat, hair salon and a Rite Aid pharmacy. Petitioners' restaurant had

seating for 26 people, consisting of 3 tables of 2, 2 tables of 4 and 3 large booths which could seat 4 in a booth. The menu for the restaurant showed the following hours: Monday through Thursday, 11:00 A.M. to 10:30 P.M.; Friday and Saturday 11:00 A.M. to 11:30 P.M.; Sunday, 12:00 noon to 10:00 P.M. The restaurant featured a special lunch menu from 11:00 A.M. to 3:00 P.M. with dishes ranging in price from \$3.95 to \$4.95. The dinner menu featured “Chef’s special Szechuan and Hunan dishes” ranging in price from \$5.75 to \$9.60 and Cantonese dishes ranging in price from \$7.50 to \$10.95.

3. Lorraine Juriga, an investigator with the Division of Taxation (“Division”), regularly reviewed restaurant listings in telephone directories to ensure that such businesses were registered with the Division and were collecting and remitting sales tax on their sales. In the spring of 2003, the investigator could not locate in the Division’s computer system an entry for petitioners’ Chinese restaurant, which she had seen listed in a telephone directory.

Consequently, she made a field visit to the premises and discovered that there was not a certificate of authority to collect sales tax posted. After introducing herself and leaving her business card with Wu Ai Zhu, from her car in the parking lot outside the premises, she performed a “mini-observation” test noting the number of customers patronizing the restaurant for approximately a three-hour period during lunchtime. The investigator estimated the restaurant sales over the three-hour period by multiplying the number of observed persons entering the restaurant by the cost of an average lunch. Subsequently, the investigator determined that the restaurant had a certificate of authority and had merely failed to post it at the premises. Using her discretion, the investigator decided not to recommend the imposition of a fine for the failure to post the certificate of authority. Nonetheless, after reviewing the sales tax filing history for the business and based upon her mini-observation test, the investigator

determined that the restaurant appeared to be underreporting its sales. As a result, petitioners' restaurant was selected for a full audit.

4. Due to the inadequacy of petitioners' records,<sup>1</sup> the auditor, Cynthia Thomas, and Investigator Juriga performed an observation test on Thursday, October 23, 2003, of the restaurant sales of petitioners' Ming Moon Restaurant. This test, conducted in a thorough and professional fashion, disclosed taxable sales for the day of \$497.51, with a head count of 98 customers. Although as noted in Finding of Fact "2", the restaurant's menu noted its closing time on a weekday night as 10:30 P.M., the restaurant was closed at 7:30 P.M., with two customers turned away moments later. In addition, a light snow flurry had made for wet roads, and as a result, Wu Ai Zhu commented to the auditor that "business was slower than usual." Furthermore, the auditor heard a customer say upon paying the tab, "Should be more than that, I had four dinners."

5. Utilizing the observed total taxable sales for the day of the observation test of \$497.51, the auditor calculated an error rate of 1.5985 to be utilized for the later period at issue of March 1, 2002 through August 31, 2003 as follows. She took the total of the restaurant's *reported* taxable sales for the period December 1, 2002 through November 30, 2003 of \$67,012.00 and divided such amount by 350 days<sup>2</sup> to determine a daily amount for *reported* taxable sales of \$191.46. She then calculated additional daily taxable sales of \$306.05 by subtracting the daily amount of taxable sales as reported by the restaurant of \$191.46 from taxable sales for the day of the observation of \$497.51. To calculate the error rate of 1.5985, she divided additional daily

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<sup>1</sup> Petitioners did not have any records to substantiate sales such as cash register tapes, guest checks, cash receipts journal, sales journal, or day book.

<sup>2</sup> The auditor estimated that the restaurant was closed on 15 days in the course of a year as a result of holidays, vacation days, illness of the two principals, etc.

taxable sales of \$306.05 by the average daily taxable sales reported of \$191.46. When expressed in a percentage format, this error rate of 1.5985 equates to 159.85%. The auditor then applied this percentage to the reported taxable sales of the Ming Moon Restaurant for each of the sales tax quarters included in the later period at issue of March 1, 2002 through August 31, 2003, during which the restaurant was operated by petitioner Ming Moon Kitchen, LLC. As a result, the auditor computed additional sales tax due of \$10,595.03 as follows:

Quarter ending	Reported taxable sales	Error rate	Additional taxable sales	Tax Due @ 7.25% rate
05/31/02	\$15,309.00	159.85%	\$ 24,471.44	\$ 1,713.00
08/31/02	15,211.00	159.85%	24,314.78	1,702.03
11/30/02	14,923.00	159.85%	23,854.42	1,669.81
02/28/03	15,827.00	159.85%	25,299.46	1,770.96
05/31/03	15,921.00	159.85%	25,449.72	1,781.48
08/31/03	16,893.00	159.85%	27,003.46	1,957.75
Totals	\$94,084.00		\$150,393.28	\$10,595.03

6. For the earlier period at issue of September 1, 2000 through February 28, 2002, the auditor utilized the observed total taxable sales for the day of the observation test of \$497.51 as the basis for calculating an error rate of 1.8418 as follows. She took the total of the restaurant's *reported* taxable sales for the period December 1, 2001 through November 30, 2002 of \$61,276.00 and divided such amount by 350 days to determine a daily amount for *reported* taxable sales of \$175.07. She then calculated additional daily taxable sales of \$322.44 by subtracting the daily amount of taxable sales as reported by the restaurant of \$175.07 from taxable sales for the day of the observation of \$497.51. To calculate the error rate of 1.8418 she divided additional daily taxable sales of \$322.44 by the average daily taxable sales reported of

\$175.07. When expressed in a percentage format, this error rate of 1.8418 equates to 184.18%.

The auditor then applied this percentage to the reported taxable sales of the Ming Moon restaurant for each of the quarters included in the earlier period at issue of September 1, 2000 through February 28, 2002, during which the restaurant was operated by petitioner Wu Ai Zhu d/b/a New Ming Moon II. As a result, the auditor computed additional sales tax due of \$10,413.28 as follows:

Quarter ending	Reported taxable sales	Error rate	Additional taxable sales	Tax Due @ 6% rate
11/30/00	\$15,623.00	184.18%	\$ 28,774.44	\$ 1,726.47
02/28/01	15,841.00	184.18%	29,175.95	1,750.56
05/31/01	15,513.00	184.18%	28,571.84	1,714.31
08/31/01	15,639.00	184.18%	28,803.91	1,728.23
11/30/01	15,782.00	184.18%	29,067.29	1,744.04
02/28/02	15,833.00	184.18%	29,161.22	1,749.67
Totals	\$94,231.00		\$173,554.65	\$10,413.28

7. The Division issued a Notice of Determination, dated August 30, 2004, against petitioner Ming Moon Kitchen, LLC, asserting additional sales and use tax due of \$10,595.03 for the period, March 1, 2002 through August 31, 2003, as detailed in Finding of Fact “5”, plus interest and penalties. Penalties were imposed for underpayment of tax, including the omnibus penalty since additional tax due was more than 25 percent of the audited tax due. The Division issued a Notice of Determination, dated May 28, 2004, against petitioner Wu Ai Zhu d/b/a New Ming Moon II, asserting additional sales and use tax due of \$10,413.28 for the period September 1, 2000 through February 28, 2002, as detailed in Finding of Fact “6”, plus interest and penalties.

Penalties were imposed for underpayment of tax, including the omnibus penalty since additional tax due was more than 25 percent of the audited tax due.

8. Customers of petitioners' Chinese restaurant include students attending the State University of New York College of Technology at Delhi which is nearby. On October 23, 2003, the day of the observation test, the university was in session. In the course of a calendar year, the college is closed for several weeks. Delhi's population of approximately 5,000 is substantially augmented by the approximately 2,000 students who attend the college.

### ***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 Footnote "1", petitioners failed to provide to the auditor any records to substantiate sales such as cash register tapes, guest checks, cash receipts journal, sales journal, or day book. Consequently, the Division of Taxation's right to resort to an estimate of the restaurant'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 Grant v. Joseph*, 2 NY2d 196, 204, 159 NYS2d 150, 157, *cert denied* 355 US 869).

B. The one-day observation test described in Finding of Fact "4" was carefully performed by the Division, and the test provided a reasonable basis for estimating the restaurant's taxable sales (*see, Matter of Agnone*, Tax Appeals Tribunal, January 23, 1992 [Tribunal upheld the results of a one-day observation test and noted that precision in determining taxable sales was not required when lack of adequate records required the estimation of taxable sales]; *Matter of Sarantopoulos*, Tax Appeals Tribunal, February 28, 1991 [one-day observation test upheld]).

C. Since it is concluded that the audit method was reasonable, petitioners had the burden of proof to show, by clear and convincing evidence, that the result of the audit was unreasonably inaccurate or that the amount of tax assessed was erroneous (*Matter of Sarantopoulos, supra*). Petitioners failed to meet this fairly substantial burden (*see, Matter of Center Moriches Monument Co. v. Commr. of Taxation & Fin.*, 211 AD2d 947, 621 NYS2d 720). The minimal testimony of petitioners' representative fell far short of meeting this burden. Although it would seem that the restaurant's sales on days that the university was not in session would be less than on days when it was in session, there is no evidence in the record to support a specific percentage reduction in the restaurant's sales for days that the university was not in session (*see, Matter of Spartan Coffee Shop*, Tax Appeals Tribunal, September 14, 1989 [administrative law judge was reversed for reducing an assessment by various percentages where there was no *evidence* to support such reduction]). In addition as noted in Findings of Fact "5" and "6", taxable sales as reported by petitioners in the summer months, when presumably the student population was low, were not dissimilar from sales during other times of year. Further, the auditor's use of 350 days to determine a daily amount for reported sales, as noted in footnote "2", was also reasonable. Petitioners did not offer clear and convincing evidence to establish that the restaurant was closed more than 15 days per year. Once again, the minimal testimony of their representative was inadequate to sustain petitioners' burden of proof.

D. Although petitioners on the day of the observation test closed their restaurant at 7:30 P.M., three hours earlier than the regular closing time noted on the menu of 10:30 P.M., it is observed that the auditor did not include in her computation of sales for the day an estimate of sales for the period when the restaurant was prematurely closed, which was advantageous to petitioners. Further, the auditor also did not make any adjustment for the undercharging of a



customer as noted in Finding of Fact “4”, which was also advantageous to petitioners. In contrast, it was disadvantageous to petitioner Wu Ai Zhu that the auditor computed a higher error rate of 1.8418 for the earlier period at issue based upon her use of a daily amount for reported taxable sales from the period of December 1, 2001 through November 30, 2002. It is fairer and limits the impact of inflation and the restaurant’s “growth factor,” a reasonable concern expressed by petitioners’ representative, to use the daily amount for reported taxable sales from the later period of December 1, 2002 through November 30, 2003 to calculate an error rate. This is so even for the earlier period at issue, since the date of the observation test was October 23, 2003, a date *within* the yearly period which was used to compute the daily amount for reported sales of \$191.46. Consequently, the Division is directed to recompute its determination of tax due from petitioner Wui Ai Zhu d/b/a New Ming Moon II for the earlier period at issue by utilizing the same error rate of 1.5985 which was used for the later period at issue.

E. Finally, petitioners have not established that their 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, the underreporting of taxable sales will remain in excess of 25%, and therefore the omnibus penalty is still properly imposed.

F. The petition of Ming Moon Kitchen, LLC is denied, and the Notice of Determination dated August 20, 2004 is sustained, and the petition of Wu Ai Zhu d/b/a New Ming Moon II is granted to the extent indicated in Conclusion of Law "D", but, in all other respects is denied, and the Notice of Determination dated May 28, 2004 is to be modified to so conform.

DATED: Troy, New York  
September 27, 2007

/s/ Frank W. Barrie  
PRESIDING OFFICER