STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

GOT-A-LOT-A-DOUGH, INC. :

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, 2001 through August 31, 2004 . :

DETERMINATION
DTA NOS. 821455 AND 821471

In the Matter of the Petition :

of :

CATHERINE KUNCMAN :

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, 2001 through August 31, 2004. :

Petitioner Got-A-Lot-A-Dough, Inc., 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, 2001 through August 31, 2004.

Petitioner Catherine Kuncman 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, 2001 through August 31, 2004.

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 9, 2007 with all briefs to be submitted by November 27, 2007, which date began the six-month period for

the issuance of this determination. Petitioners appeared by Stamm & Bader (Dennis H. Stamm, CPA). The Division of Taxation appeared Daniel Smirlock, Esq. (Robert Maslyn, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly issued a notice of determination to petitioner Catherine Kuncman.

II. Whether the Division of Taxation correctly determined additional sales and uses taxes due using an indirect audit methodology.

III. Whether petitioners have established reasonable cause for the abatement of penalties.

FINDINGS OF FACT

1. Petitioner Got-A-Lot-A-Dough, Inc. (the corporation) operated two Dunkin Donuts restaurants in Island Park, New York. In September 2004, an auditor was assigned to conduct a sales tax audit.

2. On September 24, 2004, the Division of Taxation (Division) sent an appointment letter to the corporate petitioner advising it that its sales and use tax records had been scheduled for a field audit for the period December 1, 2001 through August 31, 2004. The letter stated that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." A schedule of books and records to be produced was attached to the letter.

3. On September 29, 2004, the auditor had a conversation with Mr. Stamm, a representative for the corporate petitioner. Mr. Stamm did not want to begin the audit until a hearing on a prior audit was concluded. Therefore, he refused the auditor's request for an appointment and refused to provide any books and records. After the foregoing conversation, the

auditor requested the books and records of the corporation on three or four subsequent occasions. However, books and records were never produced.

4. In the absence of books and records, the auditor subpoenaed records from the corporate petitioner's franchisor. The franchisor sent weekly sales reporting forms which disclosed weekly gross sales at each store and sales tax paid as reported by the corporate petitioner to the franchisor. The documentation included sales reported for the period December 1, 2001 through August 31, 2004 in the amount of $3,357,993.81.

5. For the period December 1, 2002 through August 31, 2004, the Division accepted as sales tax due the amount reported to the franchisor of $152,840.85. Taxable sales for that period were determined by dividing the sales tax reported to the franchisor by the sales tax rate.

6. For the period December 1, 2001 through November 30, 2002, the amount of sales tax reported was not available. For this period, the taxable sales were divided by gross sales reported to the franchisor to calculate a taxable ratio of 87.46 percent. The taxable ratio was applied to gross sales, according to the records of the franchisor, to determine taxable sales and then further multiplied by the tax rate to determine tax due in the amount of $100,008.21.

7. The amount of tax determined to be due for the two sections of the audit period resulted in a total amount of tax due for the audit period of $252,849.06. The Division subtracted the sales tax previously reported of $49,268.00 to determine that sales and use tax was due in the amount of $203,581.06.

8. The auditor also concluded that Catherine Kuncman was a person responsible for collecting and remitting sales tax because she was the only remaining officer after the other officers resigned. In addition, she was the only shareholder of the corporation.

9. On the basis of the forgoing audit, the Division issued a Notice of Determination to the corporate petitioner, assessment number L-026320515-3, dated November 14, 2005, which assessed sales and use taxes in the amount of $203,581.06, plus interest in the amount of $81,993.49 and penalty in the amount of $79,271.26, for a balance due of $364,845.81. Both statutory and omnibus penalties were assessed pursuant to Tax Law § 1145(a)(1)(i) and (vi) because the additional tax due was more than 25 percent of the audited tax due.

10. The Division also prepared a Notice of Determination, dated November 14, 2005, (assessment number L-026322237-2) which assessed sales and use taxes for the period September 1, 2002 through August 8, 2004 in the amount of $146,287.88, plus interest in the amount of $48,741.37 and penalty in the amount of $56,354.44 against petitioner Catherine Kuncman, as a responsible officer or person of the corporate petitioner. As was the case with the corporate assessments, both statutory and omnibus penalties were assessed pursuant to Tax Law § 1145(a)(1)(i) and (vi) because the additional tax due was more than 25 percent of the audited tax due. The Division did not receive a petition challenging the notice and on March 9, 2006 the Division issued a Notice and Demand for Payment of Tax Due, which assessed the same amount of tax plus penalty and accrued interest.

11. Petitioner Catherine Kuncman challenged the assessments by filing a petition, dated December 1, 2006, with the Division of Tax Appeals. To the extent pertinent to the question of timeliness, the petition stated:

> We have never received an assessment.
>
> We have just petitioned the Division of Tax Appeals on the corporate assessment. It would be unfair to assess the individual taxpayer until the corporate assessment is finalized.

12. The address on the Notice of Determination was the same as the address given on Ms. Kuncman's petition to the Division of Tax Appeals, dated December 1, 2006. There has not been any claim that the address on the notice was incorrect.

13. The audit at issue herein involves the second time that the corporate petitioner was selected for an audit. In a decision dated November 16, 2006 the Tax Appeals Tribunal affirmed the determination of the administrative law judge which, with one adjustment, sustained the notices of determinations issued to the corporate and individual petitioners (***Matter of Got-A-Lot-A-Dough, Inc.***, Tax Appeals Tribunal, November 16, 2006). According to the Tribunal's decision, the Division's conclusion that there was a deficiency of sales and use tax was based upon the results of an observation test of each of the restaurants which was conducted on January 8, 2001 and January 11, 2001, respectively. The notices of determination issued to the corporation and the responsible officer were dated May 15, 2003 and June 6, 2003, respectively. The determination of the administrative law judge was issued on February 2, 2006.

14. In the course of the audit at issue herein, the auditor conducted a brief observation or survey of each of the establishments in order to ascertain how the business was operated, how many cash registers they had and to get a sense of the volume of business. The survey indicated that both locations were "fairly busy." The taxpayers' representatives were not informed that the survey was being conducted.

15. The auditor compared the results of this audit with the result of the prior audit and determined that the prior audit missed a lot of sales.

16. The records of the corporate petitioner were prepared by the husband of Catherine Kuncman, Ben Kuncman, who is an accountant and former Internal Revenue Service agent. The accountant for the corporate taxpayer did not review the books and records, which were prepared

using QuickBooks, and merely accepted the taxpayer's figures for purposes of completing the tax return at the end of the year. The accountant also prepared the payroll tax returns and the sales tax returns based on amounts provided by Mr. Kuncman.

17. When the letter scheduling the audit appointment arrived, both the corporate accountant, who is also a former Internal Revenue Service agent, and Mr. Kuncman thought it was unfair to burden the corporate taxpayer with a second audit before the first audit was completed. It was the experience of the corporate accountant that in order to save time for the Internal Revenue Service and the taxpayer, the same kinds of adjustment that were made to a taxpayer's return on a first audit would be applied to the taxpayer's return on a second audit. This is why the corporate accountant told the Division's auditor that it would be unfair to do an audit and that he would not provide any records.

18. When the corporate accountant examined the restaurants' records for the first time, he saw cash register tapes that showed taxable sales and gross sales that were totally different from what the auditor found in the subpoenaed records but closer to the first audit's final result. According to the corporate accountant, the fees paid to Dunkin Donuts were based on the gross sales minus the sales tax reported to New York State. Mr. Kuncman, who did not appear at the hearing, told the corporate accountant that the sales tax figures given to Dunkin Donuts were inflated in order to reduce the franchise fee.

SUMMARY OF PETITIONERS' POSITION

19. At the hearing, the corporation's accountant stated that he now has numbers based on cash register tapes which he is willing to make available. However, he has not confirmed that he has a complete set of cash register tapes. Petitioner's representative also felt that the Division

should have advised him before it issued a subpoena. Petitioners' representative did not raise an issue regarding whether Ms. Kuncman is a responsible officer.

CONCLUSIONS OF LAW

A. As noted, petitioner Catherine Kuncman asserted in her petition that she did not receive the Notice of Determination. In response, the Division presented evidence and argument that the petition of Catherine Kuncman was untimely. The Division's argument is rejected because the issue of the timeliness of the petition of Catherine Kuncman is academic.

Tax Law § 1138(a)(3)(B) provides, in part:

> If such determination is identical to or arises out of a previously issued determination of tax of the corporation . . . for which such person is under a duty to act, an application filed with the division of tax appeals of behalf of the corporation shall be deemed to include any and all subsequently issued personal determinations and a separate application to the division of tax appeals for a hearing shall not be required.

In accordance with Tax Law § 1138(a)(3)(B), since the determination that tax is due from Catherine Kuncman arises out of a determination that tax is due from Got-A-Lot-A-Dough, Inc., it was unnecessary for Catherine Kuncman to file a petition.

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of AGDN, Inc***. (Tax Appeals Tribunal, February 6, 1997), as follows:

> a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (***see***, Tax Law §§ 1138[a]; 1135; 1142[5]; ***see***, ***e.g.***, ***Matter of Mera Delicatessen***, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .' (Tax Law § 1138[a]; ***see, Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43).

> When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (***Matter of Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869); exactness is not required (***Matter of Meyer v. State Tax Commn***., 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451).

C. In this case, the record establishes the Division's clear and unequivocal written request for books and records of the corporation's sales, as well as the corporation's failure to produce such books and records for the Division's review. As set forth above, a vendor is required to make its books and records available for audit on demand by the Division (***see Matter of Roebling Liquors v. Commissioner of Taxation & Finance***, 284 AD2d 669, 728 NYS2d 509, 512 [2001], ***appeal dismissed*** 97 NY2d 637, 735 NYS2d 493 [2001], ***cert denied*** 537 US 816, 154 L Ed 2d 20 [2002];Tax Law §1135[g]). The Tax Law does not permit a vendor to decide whether or when to permit the Division to conduct an audit of its records.

D. In view of the lack of any information from the corporate petitioner, the Division' s use of third-party information to obtain the amounts of the restaurants' sales and sales tax collected was proper (***see Matter of Roebling Liquors*** at 512). There is no requirement that the Division first consult with a taxpayer before issuing the subpoena.

E. Petitioners, in essence, take issue with the Division's audit result because it is imprecise. According to petitioners, the result of the first audit was more accurate and consistent with the corporation's records. It is contended that petitioners submitted erroneous figures in order to minimize fees that they had to pay Dunkin Donuts.

In order to prevail, petitioners must show "that the audit methodology used for the audit was not merely imprecise but unreasonably inaccurate and the tax assessed erroneous (***Matter of Shukry v. Tax Appeals Tribunal***, 184 AD2d 874 [1992] citing ***Matter of A & J Gifts Shop - Vanni v. Chu***, 145 AD2d 877, 878, ***lv denied*** 74 NY2d 603). Petitioners have not met this burden. To the contrary, the Division's reliance upon petitioners' own figures which they submitted to the franchisor is a completely reasonable audit methodology. Any imprecision in the results of an audit arising by reason of a taxpayer's own failure to keep and maintain records of all of its sales as required by Tax Law §1135(a)(1) must be borne by that taxpayer (***Matter of Markowitz v. State Tax Commission, supra.; Matter of Meyer v. State Tax Commission, supra.***). Petitioners do not have a right to select the Division's audit methodology (***Matter of Shukry v. Tax Appeals Tribunal***, 184 AD2d 874 [1992], ***supra***).

F. The Division imposed penalty under Tax Law § 1145(a)(1)(i) which provides for a penalty to be imposed where a person fails to pay over any tax within the time required by law and Tax Law § 1145(a)(1)(vi), which provides that any person who omits from the total amount of tax required to be shown on the return an amount in excess of 25% must pay a penalty of 10% of the amount of the omission. Tax Law § 1145(a)(1)(iii) and (vi) provide that the Division can remit the penalty if the failure to pay over the tax was due to reasonable cause and not willful neglect. Here, without any legal authority, petitioners declined to make their books and records available to the Division. Under the circumstances presented, it is concluded that petitioners have not shown that the failure to pay was due to reasonable cause and not willful neglect.

G. The petitions of Got-A-Lot-Dough, Inc., and Catherine Kuncman are denied and the notices of determination dated November 14, 2005 are sustained together with such penalties and interest as are lawfully due.

DATED: Troy, New York
May 15, 2008

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE