

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions :

of :

**SHREE PURSHOTTAM CORPORATION : DETERMINATION
AND PIYUSH PATEL, AS OFFICER : DTA NOS. 821913
AND 821867**

for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 2003 through May 31, 2006. :

Petitioners, Shree Purshottam Corporation, and Piyush Patel, as officer, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 2003 through May 31, 2006.

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on September 16, 2008 at 10:30 A.M., with all briefs to be submitted by January 9, 2009 which date commenced the six-month period for the issuance of this determination. Piyush Patel appeared pro se and on behalf of the corporation. The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUES

- I. Whether the Division of Taxation correctly determined additional sales and use taxes due using an indirect audit methodology.
- II. Whether, assuming the use of an indirect audit methodology was proper, petitioners have shown error in the audit method or result.

III. Whether petitioners have established any facts or circumstances warranting the reduction or abatement of penalties imposed.

FINDINGS OF FACT

1. Petitioner Shree Purshottam Corporation (the store) operated a convenience store in Rochester, New York. The store sold a variety of items such as dairy products, baked goods, cigarettes, lottery tickets, hot coffee, phone cards, beer and nonalcoholic drinks. Piyush Patel was the only individual with an ownership interest in the corporation. At the time of the hearing, the corporation was no longer in business. However, when it was operating, three individuals, including Mr. Patel, worked at the store.

2. In April 2006, the Division of Taxation (Division) commenced a field audit of the store. The Division reviewed the store's tax returns and contacted Mr. Patel in order to schedule an audit appointment. Mr. Patel replied that he wished to have the assistance of his accountant, Bharat Magdalia, CPA, during the conduct of the audit.

3. On May 22, 2006, the Division sent an appointment letter to Mr. Magdalia advising him that the store's sales and use tax records had been scheduled for a field audit for the period June 1, 2003 through May 31, 2006. 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.

4. Initially, the auditor did not receive any records in response to the letter. Subsequently, the Division was provided with purchase invoices from suppliers, daily z-tapes,¹ federal and state

¹ A z-tape is a departmentalized daily summary of the sales recorded on a cash register. A z-tape does not show the details of each transaction.

corporate returns, bank statements and the worksheets that the accountant used to prepare the sales tax returns for the audit period.

5. The Division reviewed the cigarette purchase invoices for the period March 2004 through August 2005 and compared the cigarette tax credits listed on the purchase invoices to the credits claimed on the store's sales tax returns in order to determine if the credits claimed on the sales tax returns were accurate. The Division concluded that petitioners accurately reported the amount of the prepaid cigarette tax credit.

6. The Division found that the petitioners' books and records were inadequate because the Division could not trace the sales tax collected to a sales tax return. In this regard, the Division noted that the sales tax recorded on the z-tapes did not match the sales tax recorded on the returns. The Division was informed that cigarettes were sold with the taxes included in the sales price. As a result, store employees entered the cigarette sales on the cash register as "grocery non-taxable" so that the cash register would not add sales tax to the price.

7. The Division ascertained that the sales tax returns were not prepared from sales documents. Rather, petitioners' accountant calculated sales by multiplying purchases by an estimated markup.²

8. Since the sales records were unreliable, the Division decided to utilize the reported sales tax credits in conjunction with an observation test to determine the sales and use taxes due. The amount of the prepaid cigarette tax credit was utilized because it was the only number on the sales tax return that the Division could substantiate. Further, the Division could then use the

² At the hearing, Mr. Patel testified that the amount of gross sales was obtained from the z-tapes and that petitioners' accountant estimated taxable sales on the basis of purchase invoices and a markup. This testimony is rejected because the record shows that the reported gross sales did not correspond with the z-tapes.

amount of the prepaid credit to calculate the number of packs of cigarettes that the corporation sold during the audit period.

9. The Division also considered the number of packs of cigarettes sold per day as a reasonable basis for estimating sales because it observed a correlation between the number of packs of cigarettes sold and the actual sales. According to the corporation's sales tax returns, the average taxable sale per pack was \$7.91. The highest taxable sale per pack was \$8.73 and the lowest was \$7.07. If there had not been a relationship between the number of packs of cigarettes sold and taxable sales, the Division would have expected a greater fluctuation. In the summer months the corporation's sales were higher than in the winter months, and the corporation's prepaid cigarette credit was also higher. This indicated to the Division that the corporation was selling more cigarettes in the summer than in the winter. The Division also considered its sampling method to be accurate because its methodology did not show substantial variation in the number of packs of cigarettes sold. An examination of the period that included August 2005 showed sales of 147 packs per day, and sales during the period that included August 2004 showed sales of 153 packs per day.

10. On August 4, 2006, the two auditors observed the store's sales from opening to closing and recorded every transaction placing them into taxable and nontaxable categories. The Division also recorded the number of packs of cigarettes sold during the day. The auditors observed total taxable sales of \$1,791.28 and 155 packs of cigarettes sold. The Division divided the observed taxable sales of \$1,791.28 by the 155 packs of cigarettes sold to determine that the corporation had taxable sales of \$11.56 for each pack of cigarettes sold. It then determined the number of packs of cigarettes sold during each quarter of the audit period by dividing the reported prepaid credits by the prepaid tax rate. The number of packs of cigarettes sold was then

multiplied by the taxable sales for each pack of cigarettes sold to determine the audited taxable sales. The reported taxable sales were subtracted from the audited taxable sales to calculate additional taxable sales of \$507,403.08 and additional tax due of \$41,405.18.

11. On the basis of its audit, the Division issued a Notice of Determination, dated September 18, 2006, to the store which assessed a deficiency of sales and use tax in the amount of \$41,405.18 plus penalty and interest for a balance due of \$63,102.87. It also issued a Notice of Determination, dated September 22, 2006, to Piyush Patel which assessed the same amount of sales and use tax plus penalty and interest for a balance due of \$63,386.30.³ The Division assessed the statutory penalty because petitioners failed to produce actual sales records and because the underpayment of tax was substantial.

12. The corporation had one cash register. Mr. Patel usually printed the z-tapes at the end of the day. If a customer asked for a receipt, Mr. Patel would print it and hand it to the customer. Mr. Patel explained that he found it difficult to keep track of each receipt.

SUMMARY OF PETITIONERS' POSITION

13. Petitioners maintain that the use of sales of packs of cigarettes to determine taxable sales is inaccurate because beer sales allegedly decrease in the winter but cigarette sales do not change. Also, cigarette sales allegedly do not provide an accurate gauge on the sale of items such as chips. It is further maintained that a Friday was not representative day because it is the busiest day of the week for a convenience store. According to petitioners, people are having parties resulting in higher sales of beer and nonalcoholic drinks. It is also alleged that a harvest festival took place on the weekend of the observation test which further inflated taxable sales.

³ The difference in the total amounts assessed is attributable to additional penalty and interest accruing during the time between the issuance of the first and second assessments.

14. Mr. Patel also stated that he paid more than \$9,000.00 to the Division when he was informed of a possible deficiency in tax.

CONCLUSIONS OF LAW

A. It is well established that any person making taxable sales is a “vendor” under Tax Law § 1101(b)(8). As such, petitioners were “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” (*Matter of AGDN, Inc.*, Tax Appeals Tribunal, February 6, 1997). The records required to be maintained “include a true copy of each sales slip, invoice, receipt, statement or memorandum.” (Tax Law § 1135[a]).

B. Here, it is undisputed that petitioners failed to maintain detailed cash register tapes during the audit period. Rather, the only record of sales which was produced was z-tapes, which did not record each individual sale. Moreover, the z-tapes were inaccurate because beer was entered into the cash register as a nontaxable item. Consequently, petitioners did not have any records from which the Division could accurately determine taxable sales. Since petitioners did not maintain any records of individual sales, there was a “clear violation” of Tax Law § 1135(a) (*see Matter of Goldner v. State Tax Commn.*, 70 AD2d 978, 418 NYS2d 477 [1979], *Iv denied* 48 NY2d 608, 423 NYS2d 1025 [1979]). Petitioners’ records were thus inadequate for the purpose of conducting an audit to determine the accuracy of their sales tax returns as filed (*see Matter of Oak Beach Inn v. Wexler*, 158 AD2d 785, 551 NYS2d 375 [1990]). Under such circumstances, the Division was authorized to use an estimated audit method, so long as such method was reasonably calculated to reflect the taxes due (*see Matter of AGDN, Inc., supra*). The use of an observation test to determine sales is a well established and acceptable audit methodology (*see e.g. Matter of Del’s Mini Deli, Inc. v. Commr.*, 205 AD2d 989, 613 NYS2d

967 [1994]; ***Matter of Club Marakesh v. Tax Commn.***, 151 AD2d 908, 542 NYS2d 881 [1989], ***lv denied*** 74 NY2d 616, 550 NYS2d 276[1989]). Further, the use of sales of packs of cigarettes as a methodology to determine the corporation's taxable sales was supported by the consistent relationship between sales of packs of cigarettes and taxable sales. The relatively consistent number of packs of cigarettes sold each day also indicates that the day chosen for the observation test was representative of the corporation's business activity.

C. Where, as in the instant matter, the use of external indices is appropriate, the burden of proof lies with the taxpayer to show by clear and convincing evidence that the audit method led to unreasonably inaccurate results or that the amount of tax assessed was inaccurate (***Matter of Del's Mini Deli, Inc. v. Commr.***). Here, petitioners raise certain objections to the reasonableness of the audit method and the accuracy of the audit result. Petitioners assert that the observation was conducted on a Friday and the start of a festival weekend. According to petitioners, the store sold many more taxable items on this day and, as a result, the sales figures were inflated. The remaining objection is that, according to petitioners, there is no rational relationship between the sales of cigarettes and many of the items sold in the store such as food or newspapers.

D. The forgoing arguments do not warrant an adjustment. Petitioners have not provided any evidence regarding the effect of the festival on the store's sales or any evidence that taxable sales were higher on the weekend than they were during the week. Even if the audit methodology is not precise, conclusory allegations of error are not sufficient to meet petitioners' burden of proof (***id***). Moreover, contrary to petitioners' remaining argument, the record does support the finding that there is a correlation between the taxable sales and sales of packs of cigarettes.

E. The Division asserted a penalty pursuant to Tax Law § 1145(a)(1)(i). Tax Law § 1145(a)(1)(i) states that any person failing to file a return or pay over any sales or use tax “shall” be subject to a penalty. This penalty may be cancelled if the failure was “due to reasonable cause and not due to willful neglect” (Tax Law § 1145[a][1][iii]). Consistent with this statute, the Division’s regulations provide that penalty imposed under Tax Law § 1145(a)(1)(i) “must be imposed unless it is shown that such failure was due to reasonable cause and not due to willful neglect” (20 NYCRR 2392.1[a][1]). The burden imposed upon a taxpayer of establishing reasonable cause has been characterized as onerous (*Matter of Philip Morris Incorporated*, Tax Appeals Tribunal, April 29, 1993).

F. Here, apparently on the basis that they made a good faith effort to comply with the Tax Law, petitioners request that the penalty be cancelled. In their memorandum, petitioners also state that they paid more than \$9,000.00 to the Division when they were informed of a possible deficiency. Neither argument is sufficient to satisfy the burden placed upon a taxpayer to establish reasonable cause. The record shows that petitioners did not maintain records from which one could accurately determine taxable sales. It further appears that petitioners were aware that certain taxable transactions were entered in a nontaxable category and did not take steps to correct the problem. Under these circumstances, it is concluded that the record does not support the finding that petitioners acted with reasonable cause and not willful neglect. Therefore, the penalties are properly sustained.

G. The petitions of Shree Purshottam Corporation and Piyush Patel are denied, and the notices of determination, dated September 18, 2006 and September 22, 2006, respectively, are sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
July 9, 2009

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE