

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
RICHMOND DELI & BAGELS, INC.,	:	DETERMINATION
AND NABILA HUSSAIN	:	DTA NOS. 823244 AND
	:	823250
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, 2005 through February 29, 2008.	:	

Petitioners, Richmond Deli & Bagels, Inc., and Nabila Hussain, 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, 2005 through February 29, 2008.

A hearing was commenced before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on April 27, 2011 at 9:30 A.M. and was concluded at the same location on April 28, 2011 at 9:15 A.M., with all briefs to be submitted by October 21, 2011, which date began the six-month period for the issuance of this determination. The time for issuance of the determination was extended for three months pursuant to 20 NYCRR 3000.5(d). Petitioners appeared by Maynard, O'Connor, Smith & Catalinotto, LLP (Aaron F. Carbone, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Lori P. Antolick, Esq., of counsel).

ISSUES

I. Whether the audit method utilized by the Division of Taxation in its audit of Richmond Deli & Bagels, Inc., was reasonable or whether petitioners have shown error in either the audit method or the result.

II. Whether penalties asserted against petitioners should be abated.

FINDINGS OF FACT

1. Richmond Deli & Bagels, Inc. (Richmond Deli) and Nabila Hussein (together referred to as petitioners) operate a deli grocery store in Staten Island, New York, selling soda, beer, cigarettes, sandwiches, prepared foods, coffee, detergent and other similar grocery items. Richmond Deli is a subchapter S corporation and Nabila Hussain is a 100% shareholder and a responsible officer of the corporation. Ms. Hussain's status as a responsible officer of Richmond Deli is conceded.

2. Richmond Deli was in operation until approximately June 12, 2008, when it was sold pursuant to a bulk sale to Annadale Gourmet, Inc. (Annadale).

3. By correspondence dated May 19, 2008, Shuk Yan Chan, an auditor of the Division of Taxation (Division), notified petitioners that their sales and use tax records had been selected for a field audit that would begin on June 26, 2008, and would cover the eleven quarterly sales tax periods from June 1, 2005 through February 29, 2008. The letter, mailed May 20, 2008, requested that petitioners have all books and records pertaining to the sales and use tax liability available for the audit, and attached to the letter was a Records Requested List that set forth in detail all of the books and records that were required to be made available.

4. The appointment letter, the records requested list, the Division's Publication 130 and two questionnaires were mailed to Richmond Deli by certified mail. Upon delivery of these

documents to Richmond Deli, on May 21, 2008, someone acknowledged their receipt by signing the return receipt provided by the United States Postal Service (USPS). The auditor did not initially recall receiving an immediate response from petitioners, and did not recall when she actually received any response.

5. Petitioners engaged John Shall, Sr., CPA, to represent and assist them during the audit process. Mr. Shall subsequently contacted the Division to reschedule the original appointment date of June 26, 2008, and executed a Consent Extending Period of Limitations for Assessment of Sales and Use Tax Under Article 28 and 29 of the Tax Law on July 22, 2008, at the request of the Division. The consent extended the date by which tax could be assessed until September 20, 2009. At hearing, Ms. Chan admitted that, although the consent was executed extending the time for an assessment to be made, she was interested in having the audit move forward quickly since the bulk sale had already taken place.

6. The audit was conducted on behalf of the Division by Team Leader George Mahase and the auditor, Ms. Chan. The audit of Richmond Deli was the first audit of a business of this type for Ms. Chan. Mr. Mahase oversaw, assisted with and approved all her decisions on the audit, crafted some of the correspondence and gave her specific guidance in many instances. Neither Ms. Chan nor Mr. Mahase visited Richmond Deli during the course of the audit, and there was no indication that either was aware of the physical size of the establishment.

7. According to her entry in the Tax Field Audit Record, on May 22, 2008, Ms. Chan prepared an analysis of cigarette credits claimed and computed estimated gross sales and additional tax due prior to the scheduled audit, prior to any review or determination as to the adequacy of petitioners' books and records, and prior to a first meeting with Mr. Shall. The resulting calculation of additional tax due was \$242,499.38. Ms. Chan sent this analysis and

calculation by facsimile to Mr. Shall at some point during the audit. Although Ms. Chan could not specify a date that she faxed the actual calculations to Mr. Shall, she believed it was after their initial meeting on August 1, 2008.

8. Ms. Chan's first opportunity to review petitioners' records was on August 1, 2008, when she and Mr. Mahase met with Mr. Shall at his office. The records provided at that time included Richmond Deli's federal income tax return for 2006; a portion of the sales tax returns covering the period December 1, 2006 through May 31, 2008; partial general ledgers for years 2006 and 2007; a balance sheet as well as revenue, expenses and retained earnings for 2005 through 2007; a purchase agreement between petitioners and Annadale; bank statements for the entire audit period; cancelled checks for the period December 1, 2007 through February 29, 2008; purchase invoices from December 2006 through February 2008; a loan summary and a chart of accounts. No cash register tapes were produced for the audit period, the federal income tax returns for 2005 and 2007 were missing, and the purchase records in addition to the general ledger for the audit period were not complete in their submission.

9. Upon review of petitioners' available records on August 1, 2008, Mr. Mahase and Ms. Chan determined petitioners records to be inadequate. The basis for Mr. Mahase's determination in large part was due to the fact that when he attempted to reconcile the bank statements for the audit period to the gross sales reported by Richmond Deli, he found that there were more than \$2 million worth of reported sales not deposited into the corporation's bank account. When petitioners were asked to explain the discrepancy, Mr. Shall indicated that the funds were used to make purchases of various products by cash. When asked to provide those purchase records, Mr. Shall requested additional time to obtain the records. Thereafter, Mr. Mahase concluded that a lack of records indicating what was purchased with cash was the same as failing to have any

internal controls, and therefore the records were inadequate to perform a detailed audit.

Likewise, Ms. Chan came to the same conclusion as Mr. Mahase, according to her handwritten notes recorded on August 1, 2008. Her reasoning was that there were no cash register tapes for the audit period, and the records did not allow for the transactions to be traced back to the original source, or forward to a final total. The auditor also noted that bank deposits were not in substantial agreement with the books and records or the sales tax returns for the same time frame, and the daily receipts were not reconciled to the sales documents and deposits.

10. At the August 1, 2008 meeting, Mr. Shall requested additional time to obtain additional documents. The Division required petitioners to produce any records by August 21, 2008.

11. After a determination that petitioner's books and records were inadequate, having received no further records from petitioners, the Division calculated additional tax due in the amount of \$247,119.71, based upon an indirect audit methodology that relied upon prepaid cigarette credits claimed by Richmond Deli on its returns for the audit period. The auditors accepted as accurate the amount of the cigarette credits claimed on petitioners' returns. These credits were used by the auditors to determine how many packs of cigarettes were sold during the audit period. Using a minimum retail cigarette selling price, the auditors calculated petitioners' minimum cigarette retail sales. Using this method they determined that cigarette sales represented an average of 22% of petitioners' reported gross sales. Mr. Mahase commented that in his experience of auditing approximately 20 cash businesses involving food and delis, petitioners' ratio of cigarette retail sales to gross sales (22%) was very high, and that led him to the conclusion that gross sales were being underreported. In other words, he believed that cigarette sales almost always represented a percentage of overall sales that is less than 22%, and

that a ratio of 22% gave him some indication that petitioners' gross sales were being underreported. In order to then determine how much underreporting occurred, Mr. Mahase chose a different estimated percentage of cigarette sales to gross sales, and recalculated petitioners' gross sales. The auditors decided that the ratio should be closer to 15%, and using the 15%, estimated petitioners' gross sales for each of the periods in issue.

The 15% estimate was attributed to an investigator's visit to petitioners' location, other third-party businesses, and the prior experience of Mr. Mahase. Ms. Chan's testimony concerning the basis for the 15% revealed that this estimated method was recommended by an investigator in Ms. Chan's office. Ms. Chan could not identify the investigator by name, she did not know which businesses in particular he investigated to come up with the calculation, she could not identify the location of the businesses used in the comparison, or whether the businesses used in the comparison to petitioner were similar deli and grocery stores. Ms. Chan speculated that the businesses that were compared to petitioners' deli "sold almost the same products."

Mr. Mahase's testimony revealed that he had performed a similar cigarette sales credit analysis on two other cases to estimate gross sales of a grocery store and deli where the businesses did not have adequate books and records to independently determine sales. No information was provided to determine how similar or different these business were when compared to Richmond Deli. In his first conversation with Mr. Shall, Mr. Mahase suggested the cigarette credit methodology and the use of 15% as an estimate, though when he referred back to the two cases on which he relied, he realized that 14% and 10%, respectively, had been applied. In both of those cases the percentages were supplied by the representatives of those taxpayers, in the context of a settlement agreement. Since Mr. Mahase had already provided petitioners with

the suggested 15%, that is the estimate he used.¹ Petitioners were not in agreement with using a 15% estimate, or the cigarette credit methodology for computing gross sales at any time.

Mr. Mahase's testimony also revealed that the investigator referred to by he and Ms. Chan was Prakash Abichandani. Mr. Abichandani's role was to look at businesses and the items they were selling, and provide feedback to the auditors as to what he observed. When Mr. Mahase questioned the investigator about his visit to Richmond Deli, the investigator agreed that the 15% that Mr. Mahase wanted to use in this computation was a reasonable percentage to use. No basis for Mr. Abichandani's agreement regarding the 15% was provided, and he was not involved in the audits where Mr. Mahase and the representatives of those taxpayers agreed to the 14% and 10%, respectively.

12. The audit report contains no reference to the visit of the investigator, no notes or report from Mr. Abichandani's visit, and there is no reference to any calculations by the investigator, what he observed, when he performed the observation or for how long he observed the business. Although a date of the investigator's visit could not be established, during the hearing, it was revealed that the investigator did not visit Richmond Deli, but he had instead observed the successor owner, Annadale, after the business was transferred in June 2008.

13. Mr. Mahase admitted that he did not have documented substantiation for the 15% estimate, and conceded that he cannot use an estimate in an indirect audit method without such documented substantiation, nor on the basis of his prior experience, without more. He explained that the 15% estimate provided to Mr. Shall was postured as an illustration of a methodology that could be used, and he asked Mr. Shall to provide a percentage that was representative of

¹ If Mr. Mahase had applied either 14% or 10% in this case, the calculation of gross sales would have been higher.

petitioners' business. When petitioners did not suggest another percentage, Mr. Mahase then used the 15% estimate and calculated gross sales on that basis.

14. As to the use of other possible audit methods, a markup test was not performed by the auditors because they did not have complete purchase records. Third-party verification was not used, because the auditors claim they did not know the vendors with whom petitioners dealt, and in addition, they believed that the cash purchases would not likely be accounted for in third-party invoices. Ms. Chan did not refer to an external index from Dunn and Bradstreet or Risk Management Assessments.

15. Petitioners presented the testimony of Mr. Shall, who is well versed in accounting and auditing practices, having experience as a CPA spanning over 30 years. Mr. Shall proffered his opinion that the indirect audit methodology used in this case is erroneous and the results derived therefrom are incapable of being reasonably accurate or reliable. The bases for his opinions are: (1) his first hand knowledge from representing petitioners during the course of this audit, (2) review of the Division's sales tax and bulk sale audit files pertaining to petitioners, (3) review of the pertinent tax laws and regulations, the Division's policies, and guidelines concerning regularly accepted auditing and accounting practices, and (4) an observation test and mark-up analysis of Annadale that he performed. Mr. Shall memorialized his calculations, opinions, and conclusions in a report.

16. Mr. Shall observed Annadale² on September 1, 2010, approximately 2 ½ years after the end of petitioners' audit period. He testified that he had previously visited the business when it was Richmond Deli on a number of occasions. His actual observation took place from

² Mr. Shall is not the CPA for Annadale.

5:45 A.M. to 2:15 P.M., during what he deemed to be the store's busiest time. He obtained invoices for Annadale for the month of August 2010 for items that would normally be considered taxable, such as beer and soda. He claimed the invoices for Annadale were from the same three distributors used by Richmond Deli based on his experience. No documentation concerning the distributors or such invoices was introduced into evidence. Utilizing those invoices, Mr. Shall conducted a markup test for beverages for August 2010. He took the information he gathered at the observation of Annadale and applied it to the information reported on Richmond Deli's sales tax returns for the period at issue in order to determine whether a material variance existed between what was observed during the markup test and what was reported on the sales tax return. Mr. Shall concluded that the results of his markup test were normal, and that Richmond Deli's reported sales tax figures were within the regularly accepted margin of error when compared to the markup test. Mr. Shall reported taxable percentages based on his September 1, 2010 observation as follows: beer 12%, soda 5%, other beverages 10%, deli counter and coffee 25%, and cigarette sales 48%. The 48% is contrasted with a 72.8% ratio of cigarette sales to taxable sales as originally calculated by the auditors. During the observation, Mr. Shall noted only three pack of cigarettes being sold at Annadale from 5:45 A.M. to 2:15 P.M. on that day.

17. At some point during the audit, Mr. Shall indicated by correspondence that he was in the process of obtaining purchase invoices from third parties that represented a large segment of taxable sales. These invoices were never provided to the auditors.

18. At the hearing, the Division presented a rebuttal analysis of Mr. Shall's report. The rebuttal relied in large measure upon the tax return of Annadale, during a period preceding the observation. The purpose of the Division's analysis was to determine if the Division could utilize the figures from Mr. Shall's observation as a predictor of the liability of Richmond Deli.

It appears from the record that the Division did not place much emphasis upon this analysis. The Division continued its use of the cigarette credit methodology in order to calculate petitioners' alleged underreported sales.

19. The Division issued a Notice of Determination dated September 2, 2008 to Richmond Deli assessing additional sales and use taxes in the amount of \$247,119.71, plus penalty and interest, for the period June 1, 2008 through February 29, 2008.

The Division issued a Notice of Determination to Nabila Hussain dated September 19, 2008, which assessed tax in the amount of \$247,119.71, plus penalty and interest, for a total amount due of \$380,823.65 for the period June 1, 2005 through February 29, 2008. The Notice of Determination advised Ms. Hussain that it was being issued because she was an officer or responsible person of Richmond Deli and Bagels, Inc.

20. The Division submitted into evidence a press release, dated December 23, 2003, from the New York County District Attorney's Office. It described the guilty plea of a businessman named Mohammed Hussain, concerning the evasion of approximately \$1.1 million in New York State and City sales taxes over a 4½ year period in connection with 22 family-owned bagel shops, delicatessens, superettes, 24-hour convenience stores and newsstands and one gas station, most of which were located in Staten Island. Mr. Hussain owned the stores with his wife, according to the news release. The document does not specifically mention Nabila Hussain or Richmond Deli.

21. Petitioners submitted 11 proposed findings of fact. In accordance with State Administrative Procedure Act § 307(1), the disposition of the proposed findings of fact offered by petitioner is as follows:

a) The proposed findings of fact 1 through 9 have been generally accepted, but modified to more accurately reflect the record, with conclusive statements and extraneous information eliminated; and

b) Proposed findings of fact 10 and 11³ have been largely omitted due to the nature of their conclusive statements; however, some factual information contained therein has been accepted and included in the Findings of Fact set forth above.

SUMMARY OF THE PARTIES' POSITIONS

22. Petitioners maintain that the indirect audit methodology that the Division utilized is unsubstantiated, erroneous and lacks a rational basis, making it incapable of producing a reasonably accurate result. Accordingly, the assessments derived from a method lacking a rational basis are erroneous and must be cancelled.

23. The Division argues that it was authorized to estimate sales tax due from petitioners for the periods at issue since they did not produce adequate records for a detailed audit to be performed. The Division's choice of methodology was reasonable and based upon the information it had available to determine tax due, and petitioners have not sustained their burden of proof to show that the assessments are erroneous.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every "retail sale" of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A "retail sale" is "[a] sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . ." (Tax Law § 1101[b][4][i][A]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient,

³ Proposed finding of fact 11 is found in petitioners' reply brief as #1.

the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices”

When acting pursuant to section 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.*, as follows:

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, [102 AD2d 352, 477 NYS2d 858]) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is “virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit” (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), “from which the exact amount of tax due can be determined” (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of*

Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, “[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case” (*Matter of Grecian Sq. v. Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

C. In the present matter, it is clear that petitioners, though requested to do so by the Division, did not provide sufficient sales records for the audit period to enable the auditors to perform a detailed audit. Without complete records, the Division was within its rights to resort to an estimated audit methodology to determine whether petitioners had properly remitted sales and use taxes for the audit period. The only questions presented in this case are whether petitioners have established that the audit methodology employed, based upon cigarette tax credits claimed and the sales reported, was unreasonable and whether the amount of tax assessed as the result of the application of the method used in this case was erroneous (*Matter of Surface Line Operators Fraternal Organization v. Tully*).

D. Petitioners argue that the methodology utilized by the auditors, based upon reported cigarette tax credits claimed, is not an acceptable audit methodology, that it lacks a rational basis and was not capable of producing a reasonably accurate result. Additionally, petitioners suggest that other types of tests could have and should have been chosen instead.

The Division’s auditors utilized the same cigarette tax credits methodology that formed the basis of assessments in two audits previously conducted by Mr. Mahase, and relied on ratios used in those audits of cigarette sales to total sales, estimated at 10% and 14%, respectively. In fact, even prior to the first meeting with petitioners’ representative and prior to any analysis that could lead to a determination that petitioners’ records were inadequate for a detailed audit, the auditors had already commenced calculations of sales tax due on unreported sales. The auditors claim

their decision to use this methodology rather than another was based on the limited information made available to them and their own office practice and experience. The Division maintains that it is entitled to rely on its prior audit experience and office practices in its estimation process, particularly in light of the corporation's failure to supply any reliable records or information concerning its sales, arguing that an auditor's experience is a rational basis for estimating taxable sales when performing its calculations, citing *Matter of Oak Beach Inn Corp. v. Wexler*, (158 AD2d 785 [1990]) and *Matter of Hanratty's/732 Amsterdam Tavern v. New York State Tax Comm'n*, (88 AD2d 1028 [1982], *lv denied* 57 NY2d 608 [1982]). However, reliance on the auditor's experience is not without parameters, and where the audit methodology is based on facts that are peculiarly within the knowledge of the Division, such as with audits of similar establishments, the Division has the obligation to describe these facts in response to the petitioner's inquiries at hearing (*see Matter of Basileo*, Tax Appeals Tribunal, May 9, 1991).

The Tax Appeals Tribunal in *Matter of Basileo* stated:

While it is true that 'considerable latitude is given an auditor's method of estimating sales under such circumstances as exist' in each case (*Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221), certain limitations have been placed on this principle. It is necessary that the record contain sufficient evidence to allow the trier of fact to determine whether the audit has a rational basis (*Matter of Grecian Sq. v. New York State Tax Commn.*, *supra*) and, further, that the record contain specific information identifying the external index employed by the Division in estimating the taxpayer's liability (*Matter of Fashana*, Tax Appeals Tribunal, September 21, 1989). . . . We also conclude that the Division must at hearing, through witnesses or documents, be able to respond meaningfully to inquiries regarding the nature of the audit performed. Such information is necessary in order to provide petitioner with an opportunity to meet its burden of proving such methodology unreasonable (*Matter of Fokos Lounge*, Tax Appeals Tribunal, March 7, 1991).

In similarly strong language in *Matter of Abbasi* (Tax Appeals Tribunal, June 12, 2008), the Tribunal criticized the Division's use of estimates that were referred to as "habits of mind,"

and where such estimates have as their basis the Division's "experience" with little or no substantiation for their use, virtually incapable of a fair challenge by a taxpayer. Citing many of the cases previously mentioned herein, the Tribunal warned:

As a general principle, the conduct of government proceedings based on secret information, which the individual citizen has no opportunity to challenge or even examine, strongly suggests the absence of fairness. Accordingly, in order to impose on petitioner the heavy burden of proving by clear and convincing evidence that the audit methodology is unreasonable, it is not sufficient for the Division simply to present an estimated dollar amount of sales and to state that it is based on the Division's "experience." Instead, the record must contain sufficient evidence to enable the trier of fact to determine whether the audit has a rational basis, as well as specific information identifying the external index employed by the Division in estimating tax liability (*see, Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948 [3d Dept 1986]; *Matter of Spallina*, Tax Appeals Tribunal, February 27, 1992; *Matter of Fokos Lounge*, Tax Appeals Tribunal, March 7, 1991; *Matter of Fashana*, Tax Appeals Tribunal, September 21, 1989; *Matter of Savino*, Tax Appeals Tribunal, September 22, 1988).

In *Matter of Shree Purshottam Corporation* (Tax Appeals Tribunal, May 27, 2010), in a case where, as here, the sales records were unreliable, the Division also used the prepaid cigarette tax credits to calculate the number of packs of cigarettes sold, forming a basis for estimating sales. In that case, the Division determined that a relationship existed between the number of packs of cigarettes sold and the actual sales. The basis for the methodology in *Shree Purshottam* was a detailed well-documented observation test, and such test allowed the Division to establish a relationship between the taxable sales and the cigarette sales. These facts, in addition to that petitioner's failure to show that the audit results were inaccurate, supported the conclusion that the methodology in *Shree Purshottam* was reasonable.

In and of itself, the audit methodology based upon cigarette credits claimed is not improper, though it may not be the most desirable method or provide the most reliable correlation to sales. However, its use in *Shree Purshottam* can be distinguished from

petitioners' case. Most importantly, in this case, there is no similar basis to establish a percentage relationship between cigarette sales and total sales. No observation test of petitioners' business was conducted. The percentage that was used in this case, defining the relationship between cigarette sales and total sales, was drawn from neither an observation of petitioner's business, nor an observation of a similar establishment. Instead, the Division's auditors defined the percentage in this case on the basis of settlement negotiations of cases where Mr. Mahase had also suggested the use of the cigarette tax methodology. Percentages used in calculations of sales based upon settlement negotiations is not the equivalent of providing petitioners with an audit methodology to challenge or prove unreasonable. The auditors were not able to describe the rationale behind the percentages because one simply does not exist where the basis for their existence is settlement of a case. The Tax Appeals Tribunal has stated clearly that the Division must be able to respond meaningfully to petitioners' inquiries as to the nature of the audit performed (*Matter of Basileo*; *Matter of Fokos Lounge*). The Division simply could not do so, placing petitioners at a severe disadvantage. Even if the percentages relied upon by the Division had some correlation to the sales of those other audited companies, no information about the similarities or differences between Richmond Deli and the other companies was provided. It was suggested that an investigator "observed" the business operations of Richmond Deli in order to offer an opinion that the 15% was reasonable, along with the cigarette credit methodology. However, the audit file contained no information about the alleged visit, what he observed, how long that observation took, or any recorded results. Though no information about that visit was ever part of this record, it was later revealed that the investigator visited Annadale, and not Richmond Deli. The only sure fact about Annadale that was presented, is that its location is the same as its predecessor, Richmond Deli. There is only speculation on the part of

Ms. Chan that the same products were sold. There is no information about the size of the store, product line, hours it was open, number of employees or registers, sales programs or promotions. There has been no information entered into the record to establish any comparisons between petitioner Richmond Deli and Annadale. Mr. Mahase acknowledged that without documented information concerning petitioners' business, he is not permitted to estimate using an indirect audit method. The auditors admitted having no documentation for their estimate in this case, and also conceded that they could not support audit results on prior audit experience alone. Accordingly, the Division has failed in every regard to show that the methodology had a rational basis.

E. In summary, it is undisputed that petitioners did not maintain and, therefore, produce for audit, the books and records necessary to perform a detailed audit. Case law holds that, as a general proposition, any imprecision in the results of an audit arising by reason of a taxpayer's own failure to maintain adequate and accurate records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (*Matter of Meyer v. State Tax Commn.*; *Matter of Markowitz v. State Tax Commn.*). This was not mere imprecision, however. The rational basis required to be shown of the methodology simply could not be established, since the 15% estimate, from which all calculations flowed, was not verifiable, not substantiated and simply not rationally connected to the operations of petitioners' business. By clear and convincing evidence, petitioners have shown that the audit method employed was unreasonable and lacks any rational basis. Accordingly, the assessments derived from a method lacking a rational basis are erroneous and must be cancelled, and consequently, no penalties will ensue.

F. The petitions of Richmond Deli & Bagels, Inc. and Nabila Hussain are granted, and the Notice of Determination issued to Richmond Deli & Bagels, Inc., dated September 2, 2008, and the Notice of Determination issued to Nabila Hussain dated September 19, 2008, are hereby cancelled.

DATED: Albany, New York
July 5, 2012

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE