

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions	:	
of	:	DETERMINATION
<b>J. SAHANTADAM, INC.</b>	:	DTA NO. 823328
<b>AND JOHN GORMEL</b>	:	AND 823329
	:	
for Revision of Determinations or for Refund of Sales	:	
and Use Taxes under Articles 28 and 29 of the Tax Law	:	
for the Period March 1, 2005 through May 31, 2008.	:	

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Petitioners, J. Sahantadam, Inc., and John Gormel, filed petitions for revision of determinations or for refund of sales and use tax under Articles 28 and 29 of the Tax Law for the period March 1, 2005 through May 31, 2008.

A hearing was commenced before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 183 East Main Street, Rochester, New York, on March 30, 2011 at 9:30 A.M. and was concluded at the same location on March 31, 2011 at 9:30 A.M., with all briefs to be submitted by October 15, 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 Amigone, Sanchez & Mattrey LLP (B.P. Oliverio, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Lori Antolick, Esq., of counsel).

***ISSUES***

I. Whether the books and records maintained by J. Sahantadam, Inc., were sufficient for the Division of Taxation to perform a direct audit.

II. Whether the audit methodology utilized by the Division of Taxation in its audit of J. Sahantadam, Inc., was reasonably calculated to reflect the correct tax due from the corporation.

III. Whether the audit methodology produced results that were reasonably accurate.

IV. Whether the Division of Taxation properly imposed penalties against petitioners and whether petitioners have demonstrated reasonable cause to abate the penalties assessed.

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

1. Petitioner, J. Sahantadam, Inc. (petitioner) operates a restaurant named The Retreat located in Liverpool, New York. The Retreat is owned by petitioner John Gormel, the sole shareholder. Mr. Gormel's liability as the responsible officer of The Retreat is conceded by petitioners.

2. The Retreat has an American food menu, multiple rooms for seating and two bars, one inside the premises and one located outside,<sup>1</sup> which is open seasonally. The restaurant seats 184 patrons, including seats at the bar, during the time when the outdoor patio is not open, and 244 during the warmer weather when the patio is open. The restaurant was described as a casual family restaurant, with the average dinner price at approximately \$15.00. At any one time, the restaurant has about 25 wait staff and bartenders, with a few of them working full time. The restaurant has an older customer base and is not a late night location. By approximately 10:00 PM even on Fridays and Saturdays, the crowd has substantially diminished. During the summer, the outside bar is closed by 11:00 PM and the restaurant activity is very quiet by that hour.

3. John Gormel has been in the restaurant business since 1972. He purchased a former soda shop and turned it into a tavern known as The Retreat, occupying approximately 600 square

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<sup>1</sup> The outdoor bar space was doubled after 2008 and the audit period.

feet. With various additions over 39 years, it is now a restaurant and bar business, occupying approximately 6,500 square feet, in a building owned by Mr. Gormel. The business was incorporated in New York State on August 5, 1985.

4. The Retreat had not been previously audited by the Division of Taxation (Division). The audit file indicated that petitioner had reported over \$12 million dollars in sales for the audit period and had remitted over \$743,000.00 in sales tax for 10 of the 13 sales tax quarters listed.

5. Mr. Gormel also operated another entity referred to as The Cobblestone Ale House (Cobblestone) during the audit period, as a separate corporation, with a separate liquor license, and a separate checkbook. It was a bar that opened at 4:00 PM each day, and during the audit period sold little or no food and offered free peanuts.

6. The Division contacted The Retreat by correspondence dated February 4, 2008, for the purpose of scheduling an appointment for a sales tax field audit of its records for the period March 1, 2005 through December 31, 2007. Attached to the appointment letter was a Records Requested List, which set forth all of the books and records that were required to be made available for the audit. This list included the following documents, among others, that were requested for the audit period: sales tax returns, federal income tax returns, corporation tax returns, general ledger, sales invoices, exemption documents, fixed asset purchases, expense purchase invoices, bank statements, and cash receipts and disbursements journals. Additionally, the Division provided petitioners with its Publication 130-F, delineating the taxpayers' rights and responsibilities during a New York State audit.

7. During the audit, the Division provided petitioners with its Publication 900, which, among other information, explains business owners' responsibilities with regard to New York State sales tax laws, and includes detailed information concerning record-keeping requirements

as a sales tax vendor, a list of the types of records required to be maintained, and a section dealing with the consequences of a taxpayer's failure to maintain adequate records. The Division also provided petitioners with TSB-M-81(9)S, a Technical Services Bureau memorandum addressing the records required to be kept by sales tax vendors. This document delineated the necessary records in great detail as well.

8. The Division's first appointment with petitioners was on April 24, 2008. The auditor was provided boxes of invoices for capital purchases, depreciation schedules, the general ledgers, sales tax returns, sales invoices for exempt sales and corresponding exemption documentation, fixed asset purchase information, bank statements, and a disbursements journal. At the meeting the auditor identified the following documents that were needed for review: any and all point-of-sale reports, source documentation, and original guest checks for the audit period

9. The Division explained its need to review guest checks and cash register tapes, referred to as the "source documentation," in order to verify that all the sales were recorded in the general ledger, and ultimately reported on The Retreat's tax return. The Division sought to verify that the documents were sequentially numbered and that there were no missing guest checks.

10. During most of the period subjected to audit, petitioner had its original point-of-sale (POS) system in place. It was a digital dining program designed primarily to transfer the orders from the dining room into the kitchen. In or about January 2008, petitioners' new POS system replaced the old one. Under the new system, all orders must go through the computer system to the bartender or to the kitchen, or they do not get processed in order for the customers to be served. By the commencement of the audit, The Retreat had this more sophisticated POS system in place. When the Division requested to review petitioners' guest checks and cash register tapes for the entire audit period, the Division was informed by petitioners that these items were not

maintained, but instead petitioners had prepared a daily summary by server. The daily reports from petitioner's POS system were transcribed onto a handwritten daily summary, and the original documents were destroyed. The only records that were maintained for some period of time were the credit card transactions, which were maintained for a period of 18 months. Petitioners provided the Division with a year's worth of the daily handwritten sheets covering nearly all of 2007.

11. The daily handwritten sheets from The Retreat included additional information pertinent to the sales for a particular day, such as the weather forecast and events taking place in the area, and certain server information that was not included on the computerized printout of the same daily sales data. This was the explanation provided as to why petitioners chose to handwrite the information from the POS system rather than print out the computerized version. Since the data on the POS system was proprietary information, petitioners purged the POS summaries from the system and did not maintain it on the computer over the long term.

12. The Division's auditors, Greg Tienken and Edward Martorana, were provided the names of two restaurants from an audit program manager to compare to petitioners' business that contributed to the Division's determination that sales were underreported. Mr. Tienken described those restaurants as similar in entity size to petitioners', but with menus that greatly differ. When questioned about what he meant by "entity size," and why he deemed them similar to petitioners' business, he could not recall whether the comparison was based upon sales, assets or another measurement. One of the restaurants was Buckhead Corporation, doing business as Delmonico's Italian Steakhouse, and the other restaurant used for comparison purposes was Valdosta Corporation. These restaurants were determined to be part of a related group of entities in business as a chain of Italian steakhouses.

13. Petitioners' sales for 2004, 2005 and 2006 in the amounts of approximately \$3.3 million, \$3.6 million and \$3.9 million, respectively, were contrasted to Buckhead's sales at approximately \$4.5 million, \$4.8 million and \$5 million for the same years, and Valdosta's sales at approximately \$3 million, \$3.1 million and \$3.6 million for the same time frame. Although Valdosta's gross sales were closer to petitioners', given other differentiating factors and the disparity when compared to Buckhead, the auditor conceded that these companies were not comparable to petitioners' restaurant based upon sales and that his basis for comparability was probably not gross sales.

14. On or about May 21, 2008, the Division presented petitioner with a test period audit method election form for the audit of sales and recurring expense purchases. Ultimately, the test period audit election form was not used, after the Division concluded that petitioners' sales records were inadequate.

15. On June 5, 2008, the Division's auditor visited The Retreat with a friend for dinner. He observed it as a busy restaurant, with many people standing at both bars. The auditor observed eight point-of-sale stations in the restaurant.

16. On or about July 22, 2008, the Division issued a subpoena to petitioners to request the production of guest checks and cash register tapes for the entire audit period, as well as detailed transaction POS reports from the POS system for the full audit period, at the Sales Tax Unit in Syracuse, New York, on July 30, 2008. The Division did not receive the records requested in accordance with the demands of the subpoena.

17. At the time the audit was performed, the Division's auditor, Greg Tienken, had been with the New York State Department of Taxation and Finance between a year and a half to two

years. The auditor's supervisor, Edward Martorana, worked with him closely, guiding him through the audit process.

18. The Division updated and amended the original audit period in correspondence to The Retreat dated July 22, 2008. Although this correspondence updated the audit period to cover March 1, 2005 through June 30, 2008, the parties agree that the audit period was treated as covering 39 quarters, ending May 31, 2008.<sup>2</sup>

19. The Division's auditors asked to perform a test-period audit on a period after the audit period. Petitioners' representative provided detailed guest checks and other documents for a two-week period covering the end of July 2008 and the beginning of August 2008. Petitioners' bookkeeper, Wynonna McGarry, provided the auditors with the servers' cash-outs, their detailed reports, all the receipts, the credit card reports with credit slips, a CD with all the copies of saved journal information, all the reports, and a list of the servers' checks. The auditors briefly reviewed the information at the office of Mark Hettler, petitioners' CPA, and, after a couple of hours, did not attempt to perform a test-period audit, and concluded the records were inadequate because the guest checks were not in sequential order. This was the only reason provided by the auditors for determining the records to be inadequate. Mr. Tienken did not know how the guest check numbers were acquired, did not investigate the type of technology used by petitioners, or request any assistance from the Division's electronic data processing department. In addition, the auditors did not ask Mr. Hettler for any assistance or explanation of the records.

20. Once the auditor determined that there was inadequate source documentation to verify petitioners' sales for the audit period with a detailed audit, the auditor considered other audit

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<sup>2</sup> Although there seemed to be an issue as to whether the end of the audit period was May 31, 2008 or June 30, 2008, this was never clarified. However, the parties treated May 31, 2008 as the end of the audit in calculations, the actual assessment, and in most of the discussion.

methods. An observation test was considered but dismissed. The auditor did not choose this method because during a visit to the restaurant, he noted that the size of the business, the layout of the POS terminals and the number of areas that would need to be under observation would not only be difficult for the Division's auditors, but likewise, be intrusive to petitioners' business operations. A markup test was considered, but not used, because the Division could not determine how the cost of goods sold was calculated by petitioners, and because the Division believed petitioners commingled purchases of The Retreat and The Cobblestone, Mr. Gormel's other bar.

21. After the auditor determined that he could not calculate the correct amount of sales tax due without the source documentation and dismissed the use of an observation or markup test, he resorted to the Almanac of Business and Industrial Financial Ratios, 2008 Edition (the almanac), to identify different ratios that might be used to estimate the sales tax due for the audit period. The auditor explained that he chose the almanac because it summarized information from 243,000 businesses, and banks and lending institutions use the information contained in the almanac as a benchmark, upon which lending is based. He claimed to have identified the type of business in the almanac, then identified various ratios that would apply to this business, and determine the estimated sales tax due from the vendor. The auditor chose the data to be used by first identifying the category most like petitioners' principal business activity. The table he chose was entitled Food Services and Drinking Places (#722115), and the auditor narrowed his choice within this business category to the factors contained specifically in Table I from the almanac, which represented "Corporations with and without Net Income," and from Table I, compared petitioners' restaurant to those with assets ranging from \$1,000,000.00 to \$5,000,000.00. Also, under the business category entitled Food Services and Drinking Places, there existed Table II,

which represented “Corporations with Net Income.” This table was not used by the auditors in any of their computations of estimated sales, but was referred to by the parties during the hearing and in their briefs.

22. During the period in issue, The Retreat had assets ranging from \$1,043,919.00 to \$1,463,722.00, and net income of \$49,597.00, \$84,581.00, \$147,183.00 and \$208,134.00 for the years 2004 through 2007, respectively. At the time the auditor chose Table I, the 2007 return had not yet been filed; however, the years 2004, 2005 and 2006 showed a net income. The auditor believed it made sense to use Table I, Corporations with and without Net Income, when calculating petitioners’ estimated sales, because he did not know whether there would be income or loss for the business in the year 2007.

23. At the time Mr. Tienken calculated petitioners’ estimated sales, he estimated the actual operating margin for 2007 because it was not yet available to him. As a part of his calculations, he assumed that, on the basis of federal tax returns for 2004, 2005 and 2006 showing net profit, 2007 would result in a similar growth pattern and profit, and, accordingly, calculated an estimated operating margin for 2007 in the amount of \$253,560.00. For his estimated calculation of officers’ compensation for 2007, Mr. Tienken took an average of the three prior years.

24. The Retreat’s tax returns for 2007 were filed and available, and revealed actual net income from The Retreat in the amount of \$208,134.00, the Division’s auditors did not alter their choice of the almanac table from which the indices were applied, or recalculate the tax due using the actual amount.

25. Mr. Tienken examined five indices from Table I of the almanac and compared them to the information he had gathered from petitioners’ records. The first was officer wages, which Mr. Tienken dismissed as a good choice by explaining that The Retreat has only one shareholder,

who also derives income from other sources. The next index considered was wages, and this was dismissed as a good index to use because the auditor believed that the restaurant industry is notorious for underreporting wages, and he did not believe he could place his confidence in wages being accurately reported. Mr. Tienken did not recall whether he asked petitioners for the information necessary to determine proper wages and did not recall whether in making a determination not to utilize wages he reviewed payroll or other records.

Next, Mr. Tienken considered an index that utilized rent paid, and this index too was disregarded as invalid. He explained that since the building is owned by Mr. Gormel, who is also the owner of The Retreat, he is effectively paying himself rent, and that number could easily be inflated, reducing the actual wages he would pay himself, and would not be an accurate representation of the business. The fifth index that Mr. Tienken considered but disregarded was one dealing with the cost of goods sold. He could not determine how petitioners calculated cost of good sold on their federal return, he was unsure if catering fees were included, was unable to determine if cash purchases were being reported, and he could not determine what was being sold and in what portions due to the lack of guest checks.

The last index, operating margin before officers' compensation, was the index used to estimate petitioners' revenues. Edward Martorana indicated that he directed the use of this index because he believed it essentially represents the profit of a single-owner business and would be a conservative approach to the estimate.

26. At some point during the audit, in an attempt to broaden his horizons with respect to ratios that might be used to estimate petitioners' sales, Mr. Tienken located a professional article by Richard Williams, a restaurant industry expert and president of HVS Food and Beverage Services, where the relationship between gross sales and rent paid was discussed. Mr. Tienken

contacted Mr. Williams for his advice concerning this case in order to determine a rent factor for 2008, expressed in terms of a percentage of gross sales, that might be applied herein. The response was that the rent factor usually falls between 5% and 8% for a business of this kind. Petitioners' rent paid for the years 2004 through 2007 was consistently 6.9% to 7% of sales. When asked if he took this information into consideration, Mr. Tienken indicated that, "I did take it into consideration, but at the end it was kind of determined that since the building is owned by the owner of the business, that it was not, again, a fair representation of what the fair market rent would be."

27. On or about April 29, 2008, petitioner J. Sahantadam, Inc., executed a consent extending the period of limitations for assessment of sales and use taxes for the period March 1, 2005 through August 31, 2005, until September 20, 2008. On or about May 21, 2008, petitioner John Gormel executed a consent extending the period of limitations for assessment of sales and use taxes for the period March 1, 2005 through August 31, 2005, until September 20, 2008.

28. In order to calculate The Retreat's estimated sales, Mr. Tienken first examined its federal returns for the years 2004 through 2006 and determined the operating margin before officer's compensation (OMBOC). For 2007, Mr. Tienken calculated an estimated operating margin using the percentage of growth and profit margins from the previous three tax years. He applied the 4.9% index corresponding to the operating margin before officer's compensation on Table I of the almanac to the OMBOC from the returns or as calculated (for 2007) to achieve estimated sales. His calculation for 2004 included only the seven months (3/1/05 to 9/30/05) contained in the audit period, and the calculation for 2007 included only the eight months (10/1/07 through 5/31/08) contained in the audit period. Finally, the auditor subtracted from the estimated sales figure the amount of sales tax that was reported and paid by petitioners for the

years in issue. This resulted in underreported estimated sales in the amount of \$6,658,106.88<sup>3</sup> and additional sales tax due in the amount of \$533,117.58.

29. The auditor performed a review of The Retreat's capital records and expense purchases during the audit. Although it was noted in the Field Audit Report that there were adequate internal control procedures in the capital portion of the business operations, the capital records were deemed inadequate since not all the records were available for review and the records that were available did not allow the Division to trace transactions back to the original source or forward to a final total. Additional taxable capital in the amount of \$14,340.00 was discovered, resulting in additional sales and use tax in the amount of \$1,147.20.

Concerning the auditor's review of expense purchase records during the audit, a determination was made that the records and the internal control procedures were inadequate. The expense purchase records were reviewed utilizing a test period method, and the period chosen was fiscal year 2006, because the auditor deemed this period representative of petitioners' business activity. The review determined that additional taxable expense purchases of \$238,888.88 were made upon which tax was not properly paid. The predominant basis for the tax due was from the repair and maintenance of real property that petitioners had treated as capital improvements. The resulting additional tax due was \$19,111.11. The amounts assessed for both capital records and expense purchases, \$1,147.20 and \$19,111.11, respectively were conceded as owed by petitioner at the hearing.

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<sup>3</sup> This amount is \$9,500.00 greater than the result calculated in the audit work paper that was reviewed in detail at the hearing. No explanation is provided for the discrepancy. However, there is no dispute as to the final corresponding sales tax assessed based upon sales. Other work papers and some of the discussion during the hearing made reference to \$6.9 as the underreported estimated sales. This amount appears to include an additional month ending 6/30/08 that was never assessed. During the hearing, the auditor confirmed that the audit period ended with 5/31/08.

30. A Statement of Proposed Audit Changes dated August 18, 2008 was issued by the Division that incorporated tax due from the three audit areas, capital, expenses and sales.

31. The Division issued Notice of Determination, Assessment No. L-030621765-4, dated September 2, 2008, to petitioner J. Sahantadam, Inc., assessing additional sales and use taxes in the amount of \$553,375.89 plus penalty and interest, for a total of \$841,980.70, for the tax period March 1, 2005 through May 31, 2008. This represents tax determined on The Retreat's sales, capital expenditures and expense purchases. The amount that remains in issue is \$533,117.58, plus penalties and interest, representing tax due on sales.

The Division issued Notice of Determination Assessment No. L-030651205-8, dated September 15, 2008, to petitioner John H. Gormel, as an officer or responsible person of J. Sahantadam, Inc., assessing additional sales and use taxes in the amount of \$553,375.89 plus penalty and interest, for a total of \$845,316.27, for the tax period March 1, 2005 through May 31, 2008, based on the same computations as those forming the basis for the assessment against the business.

32. The auditor, as part of his pre-audit analysis, computed a potential underreporting of estimated sales based on 2006 wages in the amount of \$1,964,116.00. Mr. Tienken claims this calculation did not influence his later decisions in the audit. A discussion during the hearing the pre-audit analysis revealed that the auditor used an amount for wages in his calculations that was in error by approximately \$500,000.00, resulting in his estimate of petitioners' potential underreporting that was over \$2.5 million dollars in error.

33. Petitioners introduced into evidence the Sales and Use-Field, General Audit Guidelines, and questioned Mr. Tienken on numerous provisions as they related to this audit. He

did concede that the pre-audit guidelines do not direct an auditor to do a pre-audit estimate of underreporting.

34. The estimated assessment on sales as it related to the last eight months of the audit period is equivalent to The Retreat's doing \$10,000.00 worth of additional business each day of the week.

35. Guy Hibbert is the employee of The Retreat responsible for purchasing all the food products and nonalcoholic beverages, paper products, cooking supplies, utensils and chemicals. He also works on the kitchen line as a sandwich chef for limited durations and he is responsible for putting away stock, and performing some general maintenance. He orders many items through Sysco and Maines Paper and Food twice a week, and he places orders for produce five or six days a week. Sysco provides the beef, chicken, pork and fish. Maines supplies paper products in addition to food products used in the main courses. At the time of the hearing, he had been employed by The Retreat for 21 years. He expressed an opinion that to serve the amount of food equivalent to the sales estimated by the Division, the restaurant would need to have doubled the number of deliveries of produce and products that it had delivered.

36. John Gormel's son, Adam Gormel, an 11-year employee, is solely responsible for the ordering all of the alcohol sold by The Retreat, and is the manager of the servers and bartenders, sets their schedules and the cooks' schedules, and performs all the main floor management for the restaurant. Adam Gormel also has responsibility for the ordering of alcohol for the Cobblestone. Each entity receives separate invoices for the alcohol ordered for that location. He reviews the invoices, but does not see the checks issued in payment. During the hearing, he provided a detailed explanation of the system of ordering alcohol based upon industry specific sheets that account for usage, and how he interacts with sales personnel who provide the

alcoholic beverages. The liquor and beer is never paid for by cash. If on a rare occasion a cooking wine or cream sherry was needed to be quickly obtained for sauteing, he would, on occasion, approach the bartender for the cash. The item would be purchased, and then the bartender would be given the receipt for the item with any change, and that receipt would be provided to Ms. McGarry, the bookkeeper, the following day so that she could include the purchase as a cost of goods sold. Adam Gormel was the only person who spoke to the liquor and beer sales personnel each week, and who knew that no deliveries were made to The Retreat other than the liquor and beer orders he placed.

37. The quantity of alcohol that would have to be sold for the last eight months of the audit period based upon the estimate calculated by the Division would be the equivalent of approximately \$25,000.00 in alcoholic beverages each week. Adam Gormel expressed that The Retreat could not possibly serve that much additional alcohol in a given week, let alone store the quantity to produce that volume of sales.

38. Wynonna McGarry, who has been working for petitioners for 33 years, is the employee who handles petitioners' books. Her responsibilities include handling restaurant receipts, the servers' cash-outs and the bartenders' cash-outs. She described the cash-out as the following process: when a server comes in, he or she signs onto the computer where all checks are kept. When the server is done with a shift, he or she goes back to the computer and closes out. The computer prints a detailed report that indicates how much money is owed, how many credit card slips the server should have, what that total should be, how many cash tickets the server has, and how much cash the server should have. The servers take the reports, along with the credit card information and the cash, less the tips they are permitted to keep, and they place everything in a drop safe. This occurs for each of two shifts every day: one at lunch and one at

night. Ms. McGarry returns in the morning, retrieves the envelopes, and goes through all of the cash-outs and compares them to the computer printouts to be sure that the server has included the proper amount of money in the cash-out. Then Ms. McGarry takes the cash, creates a deposit ticket and walks it to the bank and deposits it. She performs these functions 6 days a week, and the 7<sup>th</sup> day is either handled by Linda Gormel, Mr. Gormel's wife, or it is left for Ms. McGarry to handle the following day.

39. Ms. McGarry was questioned about staffing and estimated receipts. She estimated that there are about 25 total servers employed at any given time by the restaurant. Many of those employees have other jobs or are attending school, and are not full time. On a Monday, for example, she indicated that there might be five servers on for lunch, five for the evening hours, and two bartenders, one for day and one for evening. On a Friday, there might be eight or nine servers for lunch, and there would be approximately ten for the evening hours, in addition to four bartenders. She estimated that for a Monday the receipts could range in any amount from under \$100 to \$150 per server, contrasted with a busy night, where a server might have \$400-\$500 in receipts. If a server is collecting \$500 in receipts, Ms. McGarry described that server as "very busy." A server could possibly record receipts of \$1,000.00 on Friday night if there are people bussing tables, expeditors carrying food, and they are the last one out the door at the end of the evening. When asked if she thought there was any possibility that The Retreat staff could handle additional sales in the amount of \$70,000.00 per week, as suggested by the results of the estimated sales determined by the Division, her response was that it was impossible, and suggested that staff, cooks and product would have to be doubled to accommodate such volume, and that the restaurant simply could not handle it.

40. The Division's auditors did not speak directly to either Mr. Hibbert, Adam Gormel or Wynonna McGarry about their roles or involvement with The Retreat.

41. Petitioners provided photos of The Retreat, including ones depicting a cold storage area, a 10' by 10' freezer, a dry goods storage area that measured approximately 200 square feet (25' by 8'), and the kitchen. These areas are limited and were not expanded during the audit period. On Friday and Saturday evenings, the busiest time in the kitchen, there are five cooks on the preparation line, and those five barely fit in the space that exists. The kitchen is a long narrow space, barely wide enough for two people to pass one another, and with four or five people working at one time, it is crowded space. The Division's auditors did not ask to see the storage areas, freezer or petitioners' kitchen.

42. On a daily basis, Mr. Gormel gives thought to the overall operations of The Retreat. He is on site every day, making sure the restaurant is maintained at a certain level of cleanliness, paying bills, overseeing the food orders by Guy Hibbert, making sure the food is prepared with a certain attractive appeal, and talking to customers. He described the business of The Retreat has having peaks and valleys. During the winter, business is "very tough," according to Mr. Gormel. Summertime, the business is a lot better; the fall and mid winter months are "blah," and during the holiday season, there is "a bounce." The business flow is also affected by the success of the local college football and basketball teams.

43. Mr. Gormel paid interest to The Retreat in amounts of approximately \$20,000.00, \$29,000.00 and \$37,000.00 a year during the years 2005 through 2007, respectively, on money he borrowed from the corporation, according to his CPA, Mr. Hettler. When the Division's audit calculations were performed, the interest income was not taken into account. Mr. Hettler calculated the affect this had on the Division's computation, since the interest income would

affect the use of the Almanac's operating margin before officer's compensation. He determined that using an annual average of \$30,000.00 of interest paid, not having taken this into account would overstate the sales calculated by approximately \$612,000.00 for each year of the audit, or approximately \$2 million dollars for the audit period.

44. Mark Hettler, the CPA who has assisted petitioners with accounting matters for the past 32 years, testified as to intimate familiarity with petitioners' facility, operations and tax returns. In the course of his involvement with this matter, Mr. Hettler was familiar with the material petitioners provided to the Division. After the assessment was made against petitioners, Mr. Hettler had a chance to review the Tax Field Audit Record and the Field Audit Report. In preparation for the hearing in this case, Mr. Hettler undertook an audit of the petitioners' sales for the period October 11, 2010 to October 17, 2010. His report, entitled "Independent Accountant's Report on Applying Agreed-Upon Procedures" represented the steps he took to analyze The Retreat's records for the one-week period and an agreement between the CPA and John Gormel as to the enumerated procedures that were followed in doing so. Mr. Hettler collected the daily guest checks from petitioners for one week, and by server, and listed them on a spreadsheet. The spreadsheet was reconciled to the daily summary that is printed from the POS system for the same time frame. Since petitioners also create a hand-posted daily summary, the daily summary printed from the system was compared and reconciled to the hand-posted daily summary. Totals from the daily summary that represent cash and credit card amounts were compared to cash and credit card postings on the bank statements. The deposits on the bank statements were then traced to petitioners' general ledger for the corresponding month. Those monthly numbers were then traced to petitioners' sales tax report for the month. Any discrepancies found by Mr. Hettler were classified by him as "very immaterial" and in some

cases, merely differences of cents. The final step in Mr. Hettler's analysis was to trace and verify that all the guest checks were accounted for each day. The guest checks are in sequential order at the time a customer enters and the check is opened. However, they do not necessarily remain in numerical order as they are listed on the daily register tape, because the daily summary lists the guest checks in the order they are closed or cashed out. Every guest check in the numerical sequence could be located and was accounted for in this analysis. After spending several days working on this analysis, Mr. Hettler concluded that petitioners' POS system was a system able to be audited.

45. The sales for the week that Mr. Hettler analyzed the POS system were approximately \$67,000.00, which if equated to an annual amount, would result in annual sales of slightly less than \$3.5 million. He compared this amount to the annual sales figures on The Retreats' federal tax returns for 2004, 2005 and 2006, where the reported sales were approximately \$3.3 million, \$3.6 million and \$3.9 million, respectively.

46. Mr. Hettler recalled interacting with the Division's auditors with respect to the test period audit that they were going to conduct in August 2008, and confirmed that the 2008 test period used by the Division would have involved the exact same information that he had available to him during the week of testing that he performed in October 2010, including all the tapes with the copies of the guest checks. He stated that the Division never completed the test-period audit, and after a less than two-hour review, concluded that they would not complete it because in examining the cash register tapes, the guest checks were not in sequential order. The Division did not seek assistance from Mr. Hettler to explain any aspects of petitioners' records on the day of this review.

47. Mr. Hettler's overall conclusion was, based upon his knowledge and interaction with petitioners and his access to their books and records, that it was not possible for an additional \$6.6 million in sales to exist compared to what had already been reported. He also firmly stated that petitioners' records were sufficient for the Division to conduct a detailed audit using petitioners' records.

48. Petitioners also presented analysis by sales tax specialist, David Gross. He concluded that the Almanac Table II for profitable restaurants was definitely more comparable to the reported sales and expenses by petitioners. He conducted additional statistical analyses regarding the comparison of The Retreat to Buckhead and Valdosta, and concluded they are not at all comparable.

#### ***SUMMARY OF THE PARTIES' POSITIONS***

49. Petitioners maintain that they had adequate books and records for a direct audit. Given the POS system and the controls put in place by the corporation, petitioners argue that there was an audit trail that could have been used by the Division. Accordingly, the use of a methodology based upon an external index was improper.

Petitioners further assert that the audit methodology utilized by the Division was contrary to its internal guidelines and protocols, and not reasonably calculated to reflect the correct tax due from the corporation.

Petitioners also argue that any penalties should be abated.

50. The Division maintains that it was authorized to estimate sales tax due for the periods at issue, the audit methodology it used was reasonable, and that petitioners have not adequately sustained their burden of proof that the audit was unreasonable and the results erroneous.

The Division also asserts petitioners have failed to show reasonable cause for abatement of penalties.

### ***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]). Under Tax Law § 1135(a)(1), “[e]very person required to collect tax shall keep records of every sale . . . in such form as the commissioner of taxation and finance may by regulation require.” These records must be kept in a manner suitable to determine the correct amount of tax due and must be available for the Division's inspection upon request for a period of three years (Tax Law § 1135[g]; 20 NYCRR 533.2[a][2]). The regulations provide that among the sales records required to be maintained are “sales slip, invoice, receipt, contract, statement or other memorandum of sale; . . . guest check, . . . cash register tape and any other original sales document” (20 NYCRR 533.2[b][1]).

B. The first question raised in this matter is whether petitioners have maintained the detailed records required by statute and regulations. The Division argues that petitioners did not provide guest checks or register tapes from its POS system for the audit period, even though petitioners had the ability to do so, and that daily summaries, particularly handwritten, are simply insufficient to replace the original source documentation in the form of guest checks and register tapes. Petitioners assert that the information obtainable from the POS system, as evidenced by the information provided to the auditors in August 2008, which was identical in character to the October 2010 information independently reviewed by Mr. Hettler, amounted to adequate books and records for a direct audit.

The long-standing statutory and regulatory authority of Tax Law § 1135(a) and 20 NYCRR 533.2(b) quite clearly require the traditional paper documentation representing all of petitioners' transactions to be maintained. Though those provisions remain a part of the governing authority on this issue, with respect to the maintenance of taxpayer records, updated technological advances have been recognized and expanded authority has been provided to taxpayers by the enactment of regulations that give taxpayers the option to choose a record retention format.

The New York State Department of Taxation and Finance has adopted regulations in order to comply with the record retention and electronic recordkeeping provisions of the New York Electronic Signatures and Records Act (L 1999, ch 4 § 3) and the federal Electronic Signatures in Global and National Commerce Act (5 USC § 552, 47 USC § 231, as added by Pub L 106-299, 114 Stat 464, et. seq.), and pursuant to those regulations, applicable to the retention of taxpayer records beginning June 1, 2001, taxpayers are generally given the option of retaining required records in either hard-copy or electronic format. The Department does not prescribe technologies or technical specifications for maintaining electronic records and does not require the use of particular types of hardware or software. The provisions apply only to the format in which taxpayer records are to be maintained (*see* 20 NYCRR 2402.1; 20 NYCRR 2402.1). 20 NYCRR 2402.2(c)(1) describes in detail the procedural components of the electronic record retention rules, in pertinent part, as follows:

A taxpayer must retain electronic records that accurately reflect the information that is required to be set forth in the records. The electronic records, either alone or in conjunction with the taxpayer's other records, must contain sufficient information in order to support and verify all of the entries that are made on the taxpayer's tax returns or informational reports, and to determine that proper taxes or other amounts that may be due. These records, either alone or together, must be reconcilable to the taxpayer's reporting periods and must create an audit trail designed so that the details underlying each of the entries made on the taxpayer's

returns or reports can be identified and made available to the department upon its request.

C. Petitioners did not provide actual guest checks or cash register tapes from the original POS system for the audit period. Though such records were required to be retained in one format or another (*see* Tax Law § 1135[g]; 20 NYCRR 533.2[a][2]; 20 NYCRR 2402.2[c][1]), from all indications, they simply did not exist for the audit period by the time the audit took place in 2008. The Division properly requested these records on numerous occasions, both verbally and in writing, and also provided petitioners with publications that set forth the record keeping requirements in great detail. Whether or not the documentation available from the original POS system would have been sufficient to meet the electronic records criteria has simply not been established.

Petitioners had a closely held business with strong internal controls. Mr. Gormel ran a tight ship, with long-term key employees that were a part of his team for most or a majority of his years as owner of The Retreat, and a CPA that spent virtually his whole career having petitioners as part of his client base. The credible testimony of Mr. Gormel, Ms. McGarry, Mr. Hibbert, and Adam Gormel revealed a system of checks and balances, strong commitment to separate internal functions, dedication to providing a quality dining experience at affordable pricing, and a strong team effort that contributed to a successful restaurant. Mr. Gormel is clearly a man who loves being in the restaurant business, and knows the workings of his business in great detail. His hand is always on the pulse of the business. Though he is without strong technology skills, he still wisely chose to have a POS system in place to more efficiently run his business and track his business transactions. Before the commencement of the audit, in early 2008, he upgraded his system to a more sophisticated system in an effort to track all transactions and provide him with as much information as possible to remain profitable. It is from this latter system that the two-

week sample documents were provided to the auditors in August 2008, as well as the information later reviewed by Mr. Hettler in his analysis. Petitioners argue that the two-week sample of records, identical in nature to those reviewed in great detail by Mr. Hettler in October 2010, were able to be audited and provided the auditors with sufficient information to utilize petitioners' actual records for the audit, project therefrom, and thereby eliminate any estimates on the basis of external indices. Mr. Hettler, petitioners' CPA for 32 years, who had intimate familiarity with petitioners' records and business, also provided credible testimony. He undertook an audit of petitioners' sales for a one-week period in 2010. He diligently traced each of the transactions and found immaterial discrepancies in the accounting of all the week's transactions. His analysis revealed several important points: (1) Petitioners' guest checks are sequential when the ticket is opened, but does not necessarily remain so, because they are listed on the daily summary in the order in which they are closed. Mr. Hettler was able to trace and account for all the guest checks in the period he tested; (2) petitioners' sales for that week, annualized, were approximately \$3.5 million; (3) petitioners' books and records were in auditable form; and (4) based upon his analysis and first-hand knowledge of petitioners' business, it was not possible that an additional \$6.6 million in sales, over and above what had been reported, could possibly exist. His conclusion about petitioners' records was that they provide a good audit trail, and should have been utilized as such by the Division. The out of sequence guest checks was the only reason given by the auditors for not utilizing these records in order to estimate petitioners' sales for the audit period. Since the only noted "flaw" in the test period records was explained, this issue no longer stood in the way of petitioners' records being sufficient to perform an estimate of sales using petitioners' own records. Even though the Division's own audit guidelines emphasize the importance of utilizing a taxpayer's records over external indices (New York State Department

of Taxation and Finance, Indirect Audit Methods Trainer's Manual, [May 2001]), and the Division might have been able to conduct this audit by use of a test period and petitioners' own records, the Division was not under an obligation to do so. Without complete records for the audit period that would serve to allow the Division to perform a detailed audit, the Division was within its rights to resort to an estimated methodology, even one that did not estimate the tax on the basis of The Retreat's post-audit records, to determine whether petitioner had properly remitted sales and use taxes for the audit period. In view of the foregoing, the next questions presented in this case are whether petitioners have established that the audit method employed 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 Org v. Tully*, 85 AD2d 858 [1981]).

D. 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, the amount of tax due shall be determined [by the Division] 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). 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 Organization. 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).

E. In *Matter of Basileo* (Tax Appeals Tribunal, May 9, 1991), the Tribunal 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).

F. The issues to be determined are whether the use of the external indices selected, specifically the 2008 Edition of the Almanac of Business and Industrial Financial Ratios, Food Services and Drinking Places category, Table I Corporations with and without Net Income, and Operating Margin before Officer's Compensation factor of 4.9%, to determine petitioners estimated sales was reasonable; whether the methodology resulting from the use of the indices was reasonably calculated to reflect the taxes due; and whether the results derived therefrom were erroneous.

The almanac provides benchmarks for evaluating an individual company's financial performance. Its data is derived from Internal Revenue Service (IRS) reporting, and tracks 50 operating and financial factors in nearly 200 industries. The use of the almanac from which to derive specific indices used to estimate sales is a rational approach by the Division for its calculations. However, as emphasized by the Tax Appeals Tribunal in *Matter of 33 Virginia Place* (December 23, 2009), "[t]here is a distinction to be made between determining whether or not it was rational for the Division to use particular external indices. . . as the basis for its audit and whether the audit methodology resulting from the use of these Reports was reasonably calculated to reflect taxes due." The Tribunal determined in *33 Virginia Place* that the restaurant industry publication used as an external index in that case to estimate sales was a rational choice where books and records were not provided to perform a detailed audit. However, the Division's actions in that case ignored the nature of the exhibit, used the data in a manner that was not intended, and created its own external index that was not a part of the data in the industry

publication, in order to estimate that petitioners' sales. The Tribunal concluded that the Division's actions did not result in a reasonably calculated audit methodology that could be upheld as the basis for that taxpayer's tax liability, and the assessments were cancelled.

G. In this case, the Division choice of the use of the almanac and the business category within the publication, entitled " Food Services and Drinking Places," were well-reasoned choices. However, though distinguishable from the errors committed in *33 Virginia Place*, what decisions the Division made from this point forward did not illustrate a methodology reasonably calculated to reflect the taxes due and, accordingly, the results derived therefrom were erroneous.

Within the Food Services and Drinking Places business category, there were two tables available to the Division; Table I depicted Corporations with and without Net Income; and Table II set forth comparative data for Corporations with Net Income. At the time the auditors were choosing which table to use, the information available to them consisted of three of the four tax years that were all or part of the subject of this audit. Tax years 2004 through 2006 showed reported net income of \$49,597.00, \$84,581.00 and \$147,183.00, respectively. When the auditors were estimating net income for 2007, in order to compute estimated operating margin before officers compensation, they made a valid assumption and projected that petitioners were likely to also have a profit in 2007, based upon petitioners' growth pattern of the three prior years. The Division's computations (Division's exhibit T, p 16) contain a footnote that clearly states this is how the computation was made. But even having projected net income for 2007, the auditors ignored the use of Table II to be applied to Corporations with Net Income, and instead used the indices in Table I, those meant for Corporations with and without Net Income, resulting in a much higher calculation of estimated sales. The reason that the auditor's gave for choosing Table I over Table II was because the 2007 return had not been filed at the time the

computations were being made. Clearly the choice of Table I was not consistent with the Division's assumption that petitioners' would have a net profit margin for 2007. Even after the filing of the 2007 return, where petitioners' reported actual net income of \$208,134.00, the Division never altered its choice of table used in the computation, or its methodology in any manner. The Division's actions were not merely inconsistent, but clearly in error, and the Division failed to articulate a reasonable explanation for its choices. The auditor's choice of Table I over Table II was a significant part of the methodology used, and it contributed to a conclusion that the manner in which these indices were used resulted in an audit methodology that was not reasonably calculated to reflect the taxes due by petitioners. This was the first of several fatal flaws in the Division's estimated calculations, though notably the most significant.

The Division estimated that petitioners had underreported an additional \$6.6 million of sales over 39 quarters. Given the credible testimony of John Gormel, Guy Hibbert, Adam Gormel, Wynonna McGarry and Mark Hettler, it was simply not possible for The Retreat to have had an additional \$6.6 million in sales over the already reported amounts in excess of \$12 million for the audit period. There was not the kitchen capacity, the storage space, the available staff, or the restaurant space to accommodate this amount of additional sales. It was not a late night restaurant, and its menu pricing was modest. Simple inquiries would have revealed that the estimates calculated by the auditors were not even within the realm of reason. These simple inquiries were not undertaken by the auditors.

Even after the estimated sales computation, had the Division's auditors performed some due diligence, this distortion would have even been more obvious. However, none was done. For example, the Division's research on the rent factor showed that for a business of this type and size, the industry expert indicated the rent should fall between 5% and 8% of gross sales.

Consistently, for all the years in issue, petitioners' corporate rent was between 6.9 and 7% of its gross sales. However, although Mr. Tienken testified that he did take this information into consideration, he eventually chose to ignore this factor, even though it was a strong indicator that petitioners' reported sales were in line with a company in this industry with these amounts of reported rent paid.

The Tax Appeals Tribunal has stated, “[w]hile it is advisable to do so, auditors are not required by law to confirm the reasonableness of the results of their chosen methodology” (*Matter of 33 Virginia Place*). However, the failure to do so has proven fatal (*id.*), and certainly would have shed valuable light on the estimated results in this case. The Division could have easily determined how unreasonable an additional \$6.6 million of sales over the audit period was in relation to the size of kitchen space, food storage space, geographic location, traffic, number of servers, chefs and bartenders. Another test of reasonableness that was completely ignored by the Division is Mr. Hettler's analysis. Though his detailed review took place two years after the audit, the Division's auditors had the same records used by him available to them in August 2008, two months after the end of the audit period. Prematurely, the auditors dismissed the usefulness of those records. The Division may not have been obligated to use test period records to estimate petitioners' sales for the assessment in this case, but once they had records that could have provided some indication as to the level of sales being produced by petitioners', it was error by the Division not to at the very least use those sales records from the test period as a guideline or benchmark of petitioners' sales, and compare it to its calculated result. At the very least, if they had not performed the analysis themselves, the auditors should have examined and considered the analysis performed by Mr. Hettler. Mr. Hettler's conclusions provided a great deal of clarity to the value and the validity of the records maintained by petitioners. Mr. Hettler's

detailed audit analysis also revealed the amount of petitioners' sales for that October week, annualized, would be approximately \$3.5 million. Even if that was deemed on the low side, comparing that amount to an average of the gross for all four years, the fact that it was October and not July, would clearly play a role, according to Mr. Gormel's testimony, and likely account for the difference. Unequivocally, Mr. Hettler voiced an opinion that an additional \$6.6 million in sales was beyond the realm of possibility.

In summary, the Division simply did not meet its obligation to chose an method that is reasonably calculated to reflect the taxes due, and it further failed to test whether its resulting estimated sales were remotely reasonable. When the Division fails to meet its obligation in this regard, and the estimates of petitioners' sales are so skewed that a calculation of taxes due cannot possibly be reasonably calculated, the assessment must be cancelled (*Matter of 33 Virginia Place*). Accordingly, the assessments against both The Retreat and John Gormel, except as modified pursuant to Finding of Fact 29, are cancelled.

H. Tax Law § 1145(a)(1)(i) imposes a penalty upon persons who fail to timely file a return or timely pay the tax imposed by Articles 28 and 29 of the Tax Law. The penalty and additional interest may be waived if "such failure or delay was due to reasonable cause and not due to willful neglect. . ." (Tax Law § 1145[a][1][iii]). In determining whether reasonable cause and good faith exist, the regulations provide several specific grounds, none of which apply herein, and also a catchall provision, which provides for a finding of reasonable cause based upon any ground for delinquency that would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay, demonstrating an absence of willful neglect (20 NYCRR 2392.1[d][5]). The taxpayer bears the burden of establishing that the actions were based upon reasonable cause and not willful neglect (*see Matter of Philip Morris*, Tax Appeals Tribunal,

April 29, 1993; *Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992, *confirmed* 193 AD2d 978, 598 NYS2d 360 [1993]; 20 NYCRR 3000.15[d][5]). The assessments on capital and expense purchases were largely due to petitioners' lack of records. Petitioners have not provided a basis for abatement of penalties on these amounts in order to carry their burden. Accordingly, the penalties on the portion of the assessment conceded by petitioners (Finding of Fact 29), will not be abated.

I. The Notice of Determination issued to J. Sahantadam, Inc. dated September 2, 2008 and the Notice of Determination issued to John Gormel dated September 15, 2008, except as conceded in accordance with Finding of Fact 29, are hereby cancelled.

DATED: Albany, New York  
July 13, 2012

/s/ Catherine M. Bennett  
ADMINISTRATIVE LAW JUDGE