STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

2350 DELAWARE PIZZERIA, INC.
D/B/A JUST PIZZA

for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2006 through February 28, 2009. :

DETERMINATION
DTA NOS. 824013 AND 824014

In the Matter of the Petition :

of :

JAMIE L. SOBON :

for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2006 through February 28, 2009. :

Petitioner 2350 Delaware Pizzeria, Inc. d/b/a Just Pizza filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2006 through February 28, 2009.

Petitioner Jamie L. Sobon filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 2006 through February 28, 2009.

A hearing was held before Herbert M. Friedman, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 183 East Main Street, Rochester, New York, on April 16, 2012 at 10:00 A.M., with all briefs to be submitted by August 23, 2012, which date began the

six-month period for the issuance of this determination. Petitioners appeared by the Law Office of Shelby Bakshi & White (Justin S. White, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Robert A. Maslyn, Esq., of counsel).

ISSUES

I. Whether it was appropriate for the Division of Taxation to use an indirect audit methodology.

II. Whether, assuming the use of an indirect audit methodology was proper, petitioners have shown error in the audit method or result.

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

FINDINGS OF FACT

1. Petitioner 2350 Delaware Pizzeria, Inc. d/b/a Just Pizza operated a pizza parlor at the corner of Delaware and Hertel Avenues in Buffalo, New York, from March 1, 2006 through February 28, 2009. Petitioner's restaurant primarily featured take-out service, although it did have one small table for customers that chose to dine there. Its usual hours of operation were daily from 11:00 A.M. through 11:00 P.M.

2. Petitioner Jamie L. Sobon was at all relevant times the sole owner of the corporate petitioner. At hearing, Mr. Sobon conceded that he was an officer or responsible person of the corporate petitioner for purposes of Tax Law §§ 1131 and 1133.[1]

3. An audit of petitioner's business was commenced by the Division of Taxation (Division) by letter dated March 3, 2009. At that time, petitioner was advised of the audit and

[1] Therefore, unless otherwise noted, the term "petitioner" shall only refer to 2350 Delaware Pizzeria, Inc. d/b/a Just Pizza.

directed to provide to the Division all books and records pertaining to its sales and use tax liability for the audit period, i.e., March 1, 2006 through February 28, 2009. Records requested by the Division included sales tax returns, worksheets and canceled checks, federal income tax returns, New York State corporation tax returns, a general ledger, a general journal and closing entries, sales invoices, exemption documents, fixed asset purchase and sales invoices, expense purchase invoices, merchandise purchase invoices, bank statements with canceled checks and deposit slips for all bank accounts, cash receipts journal, cash disbursement journal, depreciation schedules, guest checks and cash register tapes.

4. In July 2009, petitioner, through its then-representative Vincent Mangione, produced assorted records for the audit period, including various bank statements, guest checks and cash register tapes. These records were reviewed by the Division's auditor and deemed to be inadequate in order to perform a direct audit of petitioner.

5. The bank statements were found to be insufficient because they reported few or no cash deposits, which was unusual for a primarily cash business. In addition, the auditor discovered that the bank deposits totaled less than petitioner's reported sales for the period.

6. The auditor found that the guest checks provided were also inadequate. Several did not have dates or dollar totals on them, nor did they have an accompanying register receipt attached.

7. Petitioner also provided the auditor with daily summaries, or Z tapes. The auditor determined that the Z tapes, which were supposed to number the recorded transactions in consecutive numerical order, had transaction numbers missing, indicating unrecorded sales. For instance, the last transaction number on the Z tape for June 2, 2008 was 248012; yet, the first transaction number recorded on June 3, 2008 was 248074. Thus, 62 transaction numbers were unrecorded or missing between the time the register was closed and reopened the next day. The

auditor selected random weeks during the audit period to examine with regard to this incongruity and found that, on average, 400 to 500 sales transactions per week were missing. In addition, the opening and closing times recorded on the Z tapes were inconsistent with petitioner's operating hours. On several occasions, the summary tapes were closed out hours before the end of the business day, or the first recorded sale occurred well after petitioner's restaurant's opening time. As a result of the above discrepancies, which went unexplained by petitioner, the auditor concluded the Z tapes were similarly inadequate.

8. No records of any exempt sales were presented to the auditor during the course of the audit.

9. Likewise, no copies of any of petitioner's menus were provided to the auditor during the course of the audit.

10. The auditor also found that the purchase invoice records provided by petitioner were inadequate. She concluded that there was no way to verify that all invoices for the audit period were supplied. Furthermore, petitioner failed to provide invoices for dough purchases, plainly an important ingredient in the pizza business.

11. As a result of the inadequacy of the books and records relating to the amount of petitioner's sales and purchases, the auditor was unable to trace transactions back to the original source or forward to a final total. Consequently, the auditor determined that a detailed audit of the period would not be possible and decided to perform an observation test.

12. The observation test was conducted at petitioner's place of business on Friday, November 20, 2009, beginning at 10:30 A.M. and concluding at 11:30 P.M. During the test, the auditor and three other Division investigators observed 160 transactions comprised of gross cash sales of $1,257.13, and gross credit card sales of $614.36, for total gross sales of $1,871.49.

13. The auditor also examined the Z tape for that day, which showed total gross cash sales of $1,203.00, and gross credit card sales of $639.68, for total gross sales of $1,842.68. The auditor decided to use the slightly lower Z tape figures, rather than the observed totals, in order to calculate the tax owed.

14. The Z tape began with a list of the items sold on that day (e.g., "large pizza," "med pizza," "slices," and "toppings") and continued with the following entries: "GROUP TOTAL $1139.50," "TAX1 SALES $725.70," and "TAX1 $63.50." There was also a miscellaneous adjustment of "-1.30" on the tape.

15. Additionally, the Z tape included the entry "NET SALE" and the figure "$1201.70." This was also the figure identified as the amount of cash in the drawer. The auditor used this figure as petitioner's recorded net cash sales despite the fact that the Z tape indicated gross cash sales of $1,203.00. The auditor subsequently added $590.56 in net credit card sales to the net cash sales in arriving at net taxable sales of $1,792.26 for the day of the observation.

16. The Z tape also indicated in the list of items sold that petitioner sold 178 slices of pizza that day for a total of $412.50. There is no reference to tax being included in these sales on the Z tape. Thus, the latter figure was included in the aforementioned reported gross cash sales of $1,203.00 and the auditor's determined net cash sales of $1,201.70.

17. Petitioner placed a copy of its menu from January 2007 into evidence. Under the listing for slice selections, the menu states that "[s]ales tax included in slice prices only" without any further breakdown or mention of the tax treatment. Mr. Sobon testified that tax was included in the price of slices in November 2009 when the observation test occurred, but did not explain any breakdown of the sales price and tax. No other menus were placed into evidence.

18. Petitioner did not place into evidence any guest checks, individual cash register receipts, or other source sales documents except for a group of credit card receipts (with accompanying guest checks) for November 2, 2007.

19. In order to calculate the tax, the auditor compared the observation day Z tape results to petitioner's average reported net sales for nine November Fridays during the audit period (i.e., November 2, 9, 16, 23, and 30, 2007, and November 7, 14, 21, and 28, 2008). Petitioner reported total net sales of $7,197.26 for those nine days. In order to obtain an average of the daily net sales, however, the auditor mistakenly divided the total net sales by eight, rather than nine days, resulting in average reported daily net sales of $899.66. Comparing this figure with the net sales results from the observation day Z tape, or $1,792.26, the auditor computed an error rate of 1.992161%.[2] Consequently, for the audit period, she multiplied each quarter's reported sales by the error rate, subtracted the reported sales, and calculated the tax due on the remainder. Overall, petitioner reported $625,519.00 in taxable sales for the audit period; when multiplied by the error rate of 1.992161%, and after subtracting the previously reported taxable sales, the auditor found $620,615.37 in additional taxable sales. Multiplying these additional sales by the applicable tax rate (8.75%) resulted in $54,303.84 in additional tax owed by petitioner for the audit period.

20. Based on the foregoing, on March 4, 2010, the Division issued a Notice of Determination to petitioner, which assessed additional sales and use taxes due of $54,303.84, plus penalties and interest, for a total amount due of $94,480.51, for the period March 1, 2006

[2]In her testimony, the auditor mistakenly stated that she used an incorrect divisor of ten rather than nine in order to calculate the average amount of reported daily net sales. In fact, she used a divisor of eight, which although also incorrect, resulted in a higher daily sales average and, thus, a lower error rate. Although this mistake actually inured to the benefit of petitioner, the Division has chosen not to revise its determination of the tax due.

through February 28, 2009. The penalties included a statutory penalty (Tax Law § 1145[a][1][I]) and an omnibus penalty for omission of an amount in excess of 25% of the amount of taxes required to be shown on the return (Tax Law § 1145[a][1][vi]).

21. Likewise, on March 5, 2010, the Division issued a Notice of Determination to Mr. Sobon as a responsible person of petitioner. Mr. Sobon's notice, however, only covered the period between December 1, 2006 through February 28, 2009.[3] Thus, he was assessed additional sales and use taxes due of $44,324.82, plus penalties and interest, for a total amount due of $74,264.45. Mr. Sobon's penalties also included a statutory penalty and an omnibus penalty for omission of an amount in excess of 25% of the amount of taxes required to be shown on the return.

22. For each of the calendar years during the audit period, petitioner reported significantly more gross receipts or sales on its federal income tax returns than gross sales on its New York State sales tax returns. For instance, petitioner's federal income tax return for the calendar year 2007 reported $294,450.00 in gross receipts or sales. Meanwhile, its sales tax returns for the period December 1, 2006 through December 1, 2007 reported just over $184,000.00 in gross sales and services. These differences were not explained by petitioner during the audit or at hearing.

23. Petitioner presented the testimony of David Gross, a sales tax consultant and certified member of the Institute of Professionals in Taxation, in an attempt to refute the Division's audit. Mr. Gross reviewed the Division's audit report and work papers, as well as materials provided to him by Mr. Sobon, including purchase records, Z tapes, guest checks, bank statements, credit

[3]Although the Division's Field Audit Report states that Mr. Sobon was a responsible person for petitioner for the entire audit period, he was not assessed as such for the period between March 1, 2006 and November 30, 2006. The Division failed to explain this inconsistency.

card statements, and petitioner's federal income and New York State sales tax returns. In addition, Mr. Gross subsequently had an opportunity to review petitioner's menus. Except for the menus, it appears the documents reviewed by Mr. Gross were the same as had been previously provided to the Division.

24. Mr. Gross testified that he did not verify that the records provided by Mr. Sobon were complete and accurate with respect to petitioner's sales during the audit period. He also confirmed that the bank statements showed that petitioner's deposits were less than reported sales, indicating that Mr. Sobon did not deposit all of his cash receipts. Mr. Gross added that in the course of his review, he did not coordinate guest checks with the register tapes.

25. Nevertheless, Mr. Gross concluded that there were several concerns with the auditor's calculations. First, he testified that the auditor never accounted for price increases of approximately 12% on petitioner's products that occurred between 2007 and 2009. Mr. Gross acknowledged, though, that he did not compare the prices on every item sold by petitioner in reaching this conclusion. Second, Mr. Gross stated that the auditor did not correctly consider that the price of slices included sales tax and, therefore, gross sales were improperly inflated in the observation test. He added that approximately 35% of petitioner's cash sales were comprised of the sales of slices, which already included the tax and, therefore, an adjustment to that effect was warranted. Moreover, Mr. Gross pointed out that the auditor erroneously included tax from the sale of other items in the net cash sales total of $1,201.70 for the observation day. Finally, Mr. Gross found that petitioner's delivery service did not begin until 2009 and, eventually, comprised 30% of petitioner's business. Thus, applying the observation results of 2009 to the prior years, when deliveries were not made, incorrectly inflated gross sales for the audit period.

26. In his study of the auditor's observation test, Mr. Gross concluded that the auditor had

used two conflicting processes in performing her computations. He asserted that she had removed the tax and used net sales figures in obtaining the average amount of November Friday cash sales in 2007 and 2008, but failed to remove the tax from the gross cash sales on the observation day. Specifically, Mr. Gross pointed to the fact that $63.50, identified as tax on the Z tape, was included in the net cash sales figure used by the auditor. Further, Mr. Gross noted that the auditor made a typographical error when calculating the error rate by mistakenly transcribing credit card sales on November 2, 2007 as $55.55, when in fact they were $550.55. He pointed out that correcting these mistakes would change the Division's error rate in petitioner's favor.

27. As an alternative to the audit, Mr. Gross compared petitioner's reported Friday sales between May 1, 2009 and October 30, 2009 with those on the observation day. Mr. Gross concluded that sales were consistent in average during the period examined, with a steady increase through September and October. He added that the average number of items sold during the period studied was 218 per Friday, compared to the 312 recorded items sold on the observation day.

28. In addition, Mr. Gross studied petitioner's credit card sales for each November Friday during 2007 through 2009. He found that there was a significant drop in petitioner's credit card sales between November 2007 and November 2008. Conversely, the credit card sales increased almost as significantly between November 2008 and 2009. Based on this inconsistency, he concluded that it was unreasonable for the auditor to compare sales in 2009 with the other years in the audit period.

29. Mr. Gross also reviewed petitioner's purchases of pizza dough in an attempt to refute the audit. He did not review source records, but instead conferred with a representative from

petitioner's sole provider, who informed him that petitioner purchased between 30 to 70 dough balls per day and that each made one large pizza. Mr. Gross calculated that, based on the Z tape, petitioner used 42.25 dough balls on the observation day, or "roughly in the middle" of the quoted average. Mr. Gross acknowledged on cross-examination that these results did not constitute a conclusion of the total sales by petitioner on that day.

30. As a result of his studies, Mr. Gross opined that the auditor's overall conclusions were incorrect. He did not form an opinion as to whether the sales tax was accurately reported and paid by petitioner, however.

SUMMARY OF THE PARTIES' POSITIONS

31. Petitioner argues that the one-day observation test was not an accurate representation of petitioner's sales during the audit period. It states that the audit contained several errors that resulted in a failure to account for important gross revenue factors and an incorrect assessment.

32. The Division asserts that petitioner failed to produce adequate books and records on audit and, as a result, an alternative audit method was required. It adds that the estimation of the sales tax due by means of its observation test analysis was reasonable and that petitioner has not shown clearly and convincingly to the contrary. Finally, the Division argues that petitioner has not demonstrated reasonable cause justifying the abatement of the assessed penalties.

CONCLUSIONS OF LAW

A. Tax Law § 1135(a)(1) provides that:

> [e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require. Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum upon which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately.

The sales records required to be maintained include, among other things, sales slips, invoices, receipts, statements or other memoranda of sale, guest checks, cash register tapes and any other original sales documents (20 NYCRR 533.2[b][1]).

B. 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 of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . " (Tax Law § 1138[a][1]). When acting pursuant to section 1138(a)(1), the Division is required to select a method 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).

C. 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. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

D. In the present matter, the record shows that the Division made written requests for petitioner's books and records. It is undisputed that petitioner did not furnish, upon these requests, sufficient source documents such as guest checks, cash register tapes and expense purchase invoices for the performance of a detailed audit. The incomplete nature of the records provided did not allow transactions to be traced to source documentation or forward to a final total of taxable sales. Therefore, the Division properly resorted to external indices to estimate the tax due.

E. As noted above, it is petitioner's burden to prove, by clear and convincing evidence, that the audit method utilized by the Division was unreasonable or that the resulting assessment was erroneous. The use of a one-day observation test to determine gross and taxable sales for an audit period, where a taxpayer has failed to maintain adequate source documentation of sales, is supported by a large body of case law (***see Matter of Lombard v. Commissioner of Taxation & Fin.***, 197 AD2d 799 [1993] [upholding audit results based on a one-day observation test]; ***Matter of Club Marakesh v. State Tax Commn.***, 151 AD2d 908 [1989], ***lv denied*** 74 NY2d 616

[1989]). The evidence in this case in no way suggests that it was an improper method here. Thus, in order to prevail, petitioner must show that the result of the audit was unreasonably inaccurate or that the amount of tax assessed was erroneous (***see Matter of Sarantopoulos v. Tax Appeals Tribunal***, 186 AD2d 878, 589 NYS2d 102 [1992]).

F. Petitioner's argument to that effect rests on several alleged errors by the Division. First, petitioner asserts that the prices used in the 2009 observation test were considerably higher than those during the audit period. Second, petitioner maintains that the Division's calculations are skewed as it failed to consider that tax was included in the price of the slices sold or that petitioner's delivery service did not commence until 2009. Finally, petitioner alleges that the auditor's error rate is incorrect because tax on other items sold was included in net sales figures.

G. With regard to the first assertion, the change in prices during the audit period, the Division correctly points out that the statistics used by Mr. Gross to calculate price increases only included some, and not all, of the items sold. It is unclear, based on the evidence, whether or not other items sold by petitioner increased in price. Petitioner also failed to present source documentation to support its claim. Moreover, it is well settled that it is not unreasonable to extrapolate the results of a one-day observation test over the entire audit period (***Matter of Del's Mini Deli v. Commissioner of Taxation and Fin.***, 205 AD2d 989 [1994]; ***Matter of Caner Auto, Inc.***, Tax Appeals Tribunal, September 8, 2011). Hence, petitioner's argument concerning the auditor's disregard of price increases is unpersuasive.

H. Likewise, the record does not support petitioner's claim that the Division improperly failed to consider the inclusion of tax in the price of slices. Tax Law § 1132(c)(1) provides that all receipts subject to sales tax under Tax Law § 1105 are presumed to be taxable until the contrary is shown. Further, 20 NYCRR 532.1(b)(1) states that "[w]henever the customer is given

any sales slip, invoice, receipt, or other statement or memorandum of the price, amusement charge, or rent paid or payable, the tax shall be stated, charged and shown separately on the first of such documents given to him," and 20 NYCRR 532.1(b)(3) adds "[t]he words *tax included* or words of similar import, on a sales slip or other document, do not constitute a separate statement of the tax, and the entire amount charged is deemed the sales price of the property sold or services rendered." (Emphasis in original.) Simply put, the evidence does not demonstrate that petitioner separately identified the tax charged on the sale of its slices as required. There was no breakdown of the amount of tax charged or the base sales price of the slices. The Z tape for the observation day does not identify at all that tax was charged on slices. The few guest checks in evidence do not mention tax. Indeed, on this point, the record contains the 2007 menu as the only written mention of inclusion of tax. This menu plainly reads "[s]ales tax included in slice prices only," the very phrase prohibited by the aforementioned regulation. Consequently, petitioner fails to meet its burden and the entire amount reflected on the Z tape for the sales of slices must be deemed taxable (***Matter of La Cascade, Inc. v. State Tax Commn.***, 91 AD2d 784, 458 NYS2d 80 [1982]; ***Matter of S&K Smoke Shop, Inc.***, Tax Appeals Tribunal, July 18, 1991).

I. Additionally, petitioner's assertion that the audit results are skewed because of the lack of deliveries prior to 2009 does not have merit. Petitioner did not clearly and convincingly prove that it did not make deliveries prior to 2009; in fact, there is testimony to the contrary that some deliveries were made earlier in the audit period. Also, petitioner did not present source records to support its claims of increased sales due to the delivery service. As the Division correctly points out, petitioner did not prove that, based on the purported new delivery service, its business increased by 30% over the earlier years of the audit period.

J. Petitioner, however, correctly points out that the Division's error rate calculation is wrong based on the inclusion by the auditor of previously collected sales tax of $63.50 in the net sales figure of $1,201.70 from the observation day Z tape. A close examination of the Z tape for the observation day supports this conclusion. The Z tape begins with a list of group total sales of $1,139.50 and culminates in gross cash sales of $1,203.00. The difference between the totals is the intermediate entry "TAX1 $63.50," which plainly constitutes the tax paid on the referenced non-slice sales of $725.70 (***see*** Finding of Fact 14), and not additional sales.[4] Further, to conclude that the net cash sales are $1,201.70, as the auditor did, when gross cash sales are $1,203.00 is unreasonable.[5] The Division chose to use the Z tape entries for its observation test results, and, therefore, must correctly use those figures in calculating the tax (***see Matter of 33 Virginia Place, Inc.***, Tax Appeals Tribunal, December 23, 2009). Hence, the Division is directed to subtract $63.50 from gross cash sales of $1,203.00 in order to obtain the net cash sales of $1,139.50 for the observation day, and to use this latter figure as net cash sales, rather than $1,201.70, to recalculate the error rate.

K. Moreover, petitioner correctly asserts that when calculating the error rate, the Division erroneously included only $55.00 of credit card sales on November 2, 2007. The correct amount of credit card sales on that date, as demonstrated by petitioner through source receipts, was $550.55. Thus, the Division is further directed to correct the amount of credit card sales for November 2, 2007 to $550.55 in its calculation of average net sales for creation of its error rate

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[4]Multiplying $725.70 by the applicable sales tax rate of 8.75% equals $63.50.

[5]More likely, as petitioner has demonstrated, the $1.70 difference is, in fact, the miscellaneous adjustment noted on the Z tape.

and recalculate the tax, penalty and interest in the notice based on the revised error rate resulting from the modifications in Conclusions of Law J and K.[6]

L. At the hearing, petitioner offered its own analyses of sales comparisons between the observation day and other Fridays during the audit period. However, petitioner cannot invalidate the Division's audit by offering its own estimate of tax liability as a substitute for the Division's (***see Matter of Albanese Ready Mix***, Tax Appeals Tribunal, June 15, 1989; ***see also Matter of Sol Wahba, Inc. v. New York State Tax Commn.***, 127 AD2d 943 [1987]). Moreover, these analyses are fundamentally flawed as they are based on the same inadequate record of sales, that is, an incomplete set of guest checks and register tapes, that initially prompted the use of an external index. It must be noted that exactness in the outcome of the audit method is not required when it is the taxpayer's failure to maintain proper records that prevents it (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023 [3d Dept.1976], ***affd*** 44 NY2d 684 [1978]).

M. Petitioner was given numerous opportunities upon audit and at the hearing to produce source documentation to substantiate its sales tax returns. Despite that fact, its only source records placed into evidence were credit card receipts for November 2, 2007. Petitioner's inadequate and otherwise nonexistent records gave the Division the authority to use a method that was reasonably calculated to reflect the taxes due, which with the corrections called for in Conclusions of Law J and K, reaches a reasonable result. Indeed, the sales recorded by the Division during its observation were almost identical to petitioner's recorded sales on its Z tape for that day. Consequently, based on the paucity of source records, petitioner does not provide a

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[6]The record also demonstrates that in computing the average net sales per day, the auditor mistakenly divided total net sales by eight days, rather than the correct total of nine days examined (***see*** Footnote 2). It should be noted that if this correction were also to be made, the error rate would exceed that originally calculated by the Division and the tax due would exceed the amount in the statutory notice. The Division has not asserted a greater deficiency, though; therefore, no further adjustment is warranted.

basis to cancel the notices of determination (***see Matter of New York Trading Corporation***, Tax Appeals Tribunal, May 5, 2011).

N. 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 and also a catch-all, which provides for a finding of reasonable cause based upon any "ground for delinquency which 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).

Petitioner has offered no evidence upon which a finding of reasonable cause could be made. Despite ample opportunity, it simply did not produce the source records that it was required by law to maintain. Moreover, petitioner has failed to prove that the Division's assessment of omnibus penalty pursuant to Tax Law § 1145(a)(1)(vi) for omission of an amount in excess of 25% of the amount of taxes required to be shown on its tax return was improper. Accordingly, penalties assessed herein are sustained.

O. The petitions of 2350 Delaware Pizzeria, Inc. d/b/a just Pizza, and Jamie L. Sobon are granted to the extent indicated in Conclusions of Law J and K; the Division of Taxation is hereby

directed to modify the notices of determination issued March 4, 2010 and March 5, 2010 accordingly; and, except as so granted, the petitions are in all other respects denied.

DATED: Albany, New York
January 31, 2013

/s/ Herbert M. Friedman, Jr.
ADMINISTRATIVE LAW JUDGE