

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions :
of :
SILVER SADDLE DELI GROCERY, INC. : DECISION
AND AMIR MUSAED : DTA NOS. 827058
: AND 827059
for Revision of Determinations or for Refund of :
Sales and Use Taxes under Articles 28 and 29 of the :
Tax Law for the Periods September 1, 2011 through :
November 30, 2011 and December 1, 2011 through :
May 31, 2014. :

Petitioners, Silver Saddle Deli Grocery, Inc., and Amir Musaed, filed an exception to the determination of the Administrative Law Judge issued on December 21, 2017. Petitioners appeared by The Antonious Law Firm (Jacqueline S. Kafedjian, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a letter brief in opposition. Petitioners filed a reply brief. Oral argument was heard in New York, New York, on October 25, 2018, which date began the six-month period for issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the audit methodology utilized by the Division of Taxation in its audit of Silver Saddle Deli Grocery, Inc., had a rational basis and was reasonably calculated to reflect the taxes due.

II. Whether penalties asserted against petitioners should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except that we have modified finding of fact 11 to more accurately reflect the record. We have also made an additional finding of fact, numbered 24 herein, and have renumbered the Administrative Law Judge's findings of fact 24-30 as findings of fact 25-31, respectively. We have not restated the Administrative Law Judge's finding of fact 31, as that fact merely summarizes the Administrative Law Judge's treatment of petitioners' proposed findings of fact. The Administrative Law Judge's findings of fact, modified finding of fact and the additional finding of fact are set forth below.

1. Petitioner Silver Saddle Deli Grocery, Inc. (Silver Saddle) operated a small grocery store in upper Manhattan, New York, selling items such as cigarettes and cigars, beer, soda, energy drinks, candy, gum, pet food, household items such as cleaning products, soap and detergent, paper items, phone cards, and nontaxable food and grocery items. Petitioner Amir Musaed was the owner and president of Silver Saddle.

2. On July 31, 2014, the Division of Taxation (Division) sent a letter to Silver Saddle stating that the business' sales and use tax returns had been scheduled for an audit for the period September 1, 2011 through May 31, 2014, and scheduled the initial audit appointment for August 25, 2014. This was a follow-up audit, as the business was previously audited for earlier periods.

The letter further explained that all books and records pertaining to sales and use tax liability for the audit period must be available on the appointment date. Among the records specifically requested, in an attached Information Document Request (IDR), were sales tax returns, worksheets and canceled checks showing taxes paid; federal income tax returns; New

York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; exemption documents supporting non-taxable sales; chart of accounts; fixed asset purchase/sales invoices; bank statements, canceled checks and deposit slips for all accounts; cash receipts journal and sales journal; cash disbursement journal and purchase journal; the corporate book, including minutes, board of directors and articles of incorporation; depreciation schedules; lease/rental agreements; state liquor authority licenses; and lease contracts, utility bills, guest checks and cash register tapes for the entire audit period.

3. On August 8, 2014, the Division's auditor performed a survey of the business and spoke with Mr. Musaed. Mr. Musaed provided daily z tapes for the period April 20, 2014 through June 14, 2014, and informed the auditor that his attorney, Jacqueline S. Antonious, would be representing petitioners. The z tapes were not itemized and did not list the items sold. During the audit period, petitioners were equipped with a cash register machine that was not capable of itemizing the type of goods sold. During the hearing, Mr. Musaed testified that he could not remember how his accountant determined the amount of sales tax to report on the business' sales tax returns.

4. On August 13, 2014, the Division received a power of attorney for petitioners from Ms. Antonious.

5. On August 21, 2014, the Division forwarded to petitioners' representative the audit appointment letter and IDR dated July 31, 2014. Upon Ms. Antonious' request, the audit appointment was rescheduled to September 8, 2014. The auditor also sent third-party verification letters to HLA distributor, Pepsi, Coca-Cola and Jetro requesting information to determine whether these vendors had made sales to petitioners during the audit period. Coca-Cola and HLA distributor responded stating that petitioners were not customers of those vendors.

6. A field audit was conducted on September 8, 2014 at the representative's office. During the appointment, the representative provided the Division with some of Silver Saddle's bank statements, forms 1099-K (merchant cards and third-party network payments) for 2011 and 2013, a statement from Amsterdam Tobacco and sales tax returns for the audit period.

7. The Division sent a second IDR, dated September 10, 2014, to petitioners' representative, requesting federal income tax and New York State corporation tax returns; general ledger; general journal and closing entries; monthly sales summary of taxable, non-taxable sales and tax collected for the audit period; exemption documents; chart of accounts; fixed asset purchase/sales invoices; expense purchase invoices; merchandise purchase invoices; missing bank statements; cash receipts and sales journals; cash disbursement and purchase journals; corporate books; depreciation schedules; lease/rental agreements and contracts; its state liquor authority license; utility bills; form 1099-K for 2012; cash register tapes; a schedule of cigarette purchase invoices and invoices to substantiate credits for prepaid tax on cigarettes; sales tax examination, responsible person questionnaire and escalation letter; and daily z cash tape details of sales for the period April 20, 2014 through May 31, 2014.

8. A second audit appointment was conducted at the representative's office on October 3, 2014. The representative provided additional bank statements; however statements were missing for May through July 2013, January 2014 and March through April 2014. Purchase invoices were provided for Amsterdam Tobacco for the period December 2011 through May 2014, and a purchase summary was provided for Manhattan Beer Distribution for the period September 1, 2011 through May 5, 2014. During the appointment, the auditor gave petitioners' representative form AU-2.10, consent to extension of time (consent to extension), requesting that petitioners

agree to extend the statute of limitations for assessment of sales and use tax for the period September 1, 2011 through May 31, 2012.

9. On October 7, 2014 the auditor sent third-party verification letters to Krasdale, and on October 8, 2014, to North Shore Bottling Company, Beehive Beer Distributors, and the Beverage Works of New York in an attempt to obtain information regarding petitioners' purchases during the audit period.

10. On October 16, 2014, petitioners' representative informed the auditor that petitioners would not sign the consent to extension. The Division sent a letter to petitioners explaining that they may be subject to certain record keeping penalties for their failure to provide records requested by the Division.

11. Because the time in which to assess for the period of September 1, 2011 through November 30, 2011 was about to expire, and petitioners did not provide a consent to extension or all requested records, the auditor attempted to calculate the appropriate amount of tax for that period using available information. The auditor initially reviewed third-party information from the New York State database of beer, beverage and cigarette purchases, third-party information obtained in response to information requests, and cigarette purchase information provided by petitioners, in an attempt to estimate taxable sales for the audit period. The auditor initially computed petitioners' tax liability for this audit period applying a 37.93% mark-up taken from the Almanac of Business and Industrial Financial Ratios (Almanac).

The auditor's section head and program manager reviewed the file and the auditor's calculations. The program manager determined that the estimate was incomplete because it only included information for beer, beverage and cigarette purchases and did not include other items sold in the store such as household items, phone cards, candy, and other taxable items. Because

the Division was not provided with complete purchase records, the auditor and her supervisors determined that it was necessary to use another audit methodology to calculate taxable sales. The Division decided to obtain the business' lease agreement or canceled rent checks in order to calculate taxes based on a rent factor.

12. The Division also sent additional IDRs to petitioners' representative on October 16, 2014 and November 19, 2014, requesting Silver Saddle's books and records for the audit period that had been previously requested but not provided, including complete bank statements and the lease or rental agreement for the entire audit period.

13. On November 25, 2014, petitioners' representative sent additional bank statements for Silver Saddle from May through July 2013, January 2014, and March through April 2014. Deposits from food stamp transactions were reflected on the bank statements as "Efunds." The deposits reflected in the bank statements were lower than gross sales reported on Silver Saddle's sales tax returns. The auditor transcribed the bank statements provided by petitioners, including food stamp deposits.

14. Because petitioners did not provide a copy of the business' lease in response to the previously issued IDRs, the auditors requested that the Division's investigator obtain a copy of lease. The investigator obtained a copy of the business' lease from petitioners' landlord.

15. As a result of the pending expiration of the statute of limitations for the first sales tax quarter of the audit period and the inadequacy of petitioners' records, the Division's auditors decided to use IRS financial ratios contained in the IRS Corporate Financial Ratios, 29th Edition (IRS Ratios) and the business' rent expense information obtained from the lease in order to determine if there was additional tax due for that period. The Division determined that it was necessary to use the IRS Ratios rather than the Almanac because the Almanac required

information regarding deductible expenses, such as bad debts, maintenance and repairs, which was not provided to the Division by petitioners.

16. The auditor employed the IRS Ratios industry index to compute the gross sales of Silver Saddle using the rental information obtained from the lease. The publication is based on statistical data derived from a sample of over 145,000 corporation tax returns filed with the IRS with accounting periods from July 2011 through June 2012. The information is grouped by the North American Industry Classification System (NAICS), which groups businesses with similar characteristics together, such as food and beverage stores. Ratios are shown for various size classifications based on total assets, defined as: 1) \$1,000.00 to \$999,999.00; 2) \$1 million to \$24.999 million; 3) \$25 million to \$99.999 million; and 4) \$100 million or more. The classes are further separated based on profit or loss.

The Division's auditor selected the rent expense to sales ratio in the food and beverage stores category for petitioners' business. Within this category, the auditor selected the category for profitable businesses with assets values between \$1,000.00 and \$999,999.00. The auditor determined that the business was profitable because the third party purchase information obtained indicated that purchases exceeded the taxable sales reported on the business' sales tax returns. The rent factor listed for this category in the IRS Ratios and used by the auditor is 3.94%.

After determining the rent factor, the auditor divided the total rent paid by petitioners for the quarter ending November 30, 2011 (\$12,537.54) by the rent factor of 3.94% to determine gross sales of \$318,211.68 for that quarter. The auditor then subtracted food stamp sales of \$10,573.37 from gross sales to determine audited taxable sales of \$307,638.31. The auditor then subtracted reported taxable sales for the quarter of \$25,998.00, resulting in additional taxable

sales of \$281,640.31 and additional tax due of \$24,995.58. The auditor also disallowed cigarettes credit of \$524.00, resulting in tax due for the period September 1, 2011 through November 30, 2011 in the amount of \$25,519.58.

17. On December 2, 2014, the auditor conducted a third field audit appointment at petitioners' representative's office. No additional documentation was provided by petitioners at that time.

18. The Division sent an additional IDR to petitioners' representative on December 2, 2014, requesting Silver Saddle's books and records for the audit period that had been previously requested but not provided. No additional documentation was provided by petitioners in response.

19. The Division issued a notice of determination (L-042253394), dated December 5, 2014, to Silver Saddle, asserting tax due in the amount of \$25,519.58, plus penalties of \$11,207.71 and interest for the period September 1, 2011 through November 30, 2011.

20. The Division issued a notice of determination (L-042258305), dated December 8, 2014, to Amir Musaed as a responsible person of Silver Saddle, asserting tax due in the amount of \$25,519.58, plus penalties of \$11,207.71 and interest for the period September 1, 2011 through November 30, 2011.

21. On December 22, 2014, the Division sent a letter to petitioners' representative explaining that because petitioners did not provide the appropriate books and records to conduct a detailed sales and use tax audit, the Division would perform an observation of petitioners' sales and business activities.

22. By letter dated December 29, 2014, petitioners' representative informed the Division that petitioners did not consent to an observation of the business.

23. The auditor attempted to obtain consents to extend the statute of limitations for assessment of sales and use tax for the remaining quarters of the audit period, but petitioners did not sign the consents.

24. The auditor testified at the hearing that she reviewed and transcribed the z-tape summaries that were provided by petitioner Musaed during the auditor's first field visit to the business. Additionally, the audit record and auditor's testimony demonstrate that the auditor reviewed documents received during the first field audit visit to the representative's office and that she reviewed and transcribed the bank statements, including food stamp deposits received, in response to written document requests.

25. Following her review of the available documentation, the auditor concluded that petitioners' sales records were inadequate to conduct a complete audit for the remaining audit period because petitioners did not provide the required books and records. The Division determined that the lack of original source documents detailing petitioners' sales precluded the Division from tracing any transaction back to the initial sale or forward to the amount of sales reported.

26. Due to the inadequacy of petitioners' records, the Division determined that it was necessary to estimate the sales tax for the remaining audit period using an indirect audit methodology. To determine petitioners' sales tax liability for the period December 1, 2011 through May 31, 2014, the Division used the same method that had been used to determine petitioners' sales tax liability for the period September 1, 2011 through November 30, 2011, namely a rent factor.

27. Based on petitioners' lease agreement, the Division determined that Silver Saddle paid \$130,709.26 in rent for the period December 1, 2011 through May 31, 2014. The auditor

divided this amount of rent by the rent factor of 3.94%, obtained from the IRS Ratios for food and beverage stores with profitable businesses and assets values between \$1,000.00 and \$999,999.00, resulting in audited gross sales of \$3,317,493.91. The auditor then subtracted food stamp sales of \$86,196.02 to determine audited taxable sales of \$3,231,297.88. The auditor next subtracted taxable sales reported by petitioners of \$469,788.00 to determine additional taxable sales of \$2,761,509.88, and additional tax due of \$245,084.01 for the period December 1, 2011 through May 31, 2014.

28. The Division issued a notice of determination (L-042535621), dated February 24, 2015, to Silver Saddle, asserting tax due in the amount of \$245,084.01, plus penalties of \$140,415.49 and interest for the period December 1, 2011 through May 31, 2014.

29. The Division issued a notice of determination (L-042538736), dated February 25, 2015, to Amir Musaed as a responsible person of Silver Saddle, asserting tax due in the amount of \$245,084.01, plus penalties of \$140,451.49 and interest for the period December 1, 2011 through May 31, 2014.

30. The notices of determination at issue asserted statutory penalties pursuant to Tax Law § 1145, omnibus penalties based on omissions over 25% of the tax required to be shown on the sales tax returns, and penalties for failure to produce books and records.

31. The Division determined that petitioners were entitled to prepaid cigarette credits in the amount of \$6,383.00. Petitioners filed a refund claim for this amount. During the hearing, the Division stipulated that the credit should be netted against petitioners' final liability, or if it is determined that petitioners owe no additional tax for the period at issue, petitioners would be entitled to a full refund of \$6,383.00.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge began her determination with a review of the record keeping requirements for sales tax vendors and the Tax Law provisions relating to the determination of sales tax by the Division. She addressed the standard for reviewing a sales tax audit where, as in this case, an indirect audit methodology had been used in the determination of sales tax liability. She found that the Division was within its authority to use an indirect audit methodology due to incomplete and insufficient records produced by petitioners. She discussed prior decisions of this Tribunal in which a rent factor had been used to estimate a taxpayer's gross sales and determined that a rent factor as used by the Division was an appropriate methodology to estimate sales in this case.

The Administrative Law Judge found that petitioners had not met their burden of establishing that the audit method was unreasonable or that the amount of tax assessed was erroneous. She found that petitioners did not maintain adequate records of sales as required by the Tax Law for the period in question and their argument that the Division should have used a different audit methodology was unpersuasive. She determined that the Division is under no obligation to use one indirect audit method as opposed to another, but rather must only select a method of audit reasonably calculated to determine the amount of tax due. She noted that the taxpayer bears any imprecision in the results of an audit methodology that arises by reason of a taxpayer's own failure to maintain and provide records of its sales as required by the Tax Law. The Administrative Law Judge found petitioners' arguments in opposition to the Division's audit methodology meritless. Specifically, she determined that the Division's auditors clearly described the use of the rent factor and the reasons for choosing that particular methodology. She also found that the Division properly identified and introduced into the record the IRS Ratios

publication on which its calculations were based. Additionally, the Administrative Law Judge found meritless petitioners' argument that the Division's assessment made no reasonable allowance for ordinary nontaxable sales, other than food stamp purchases, since petitioners did not provide any documentation to determine nontaxable sales and did not consent to an observation. Finally, the Administrative Law Judge determined that the waiver of penalties is not justified in this case as petitioners failed to make adequate books and records available for audit and underreported and underpaid the tax due. She thus denied the petitions and sustained the notices of determination.

ARGUMENTS ON EXCEPTION

On exception, petitioners argue that the auditor's application of a rent factor to determine gross sales was arbitrary and capricious and, as such, rendered the computation of taxable sales unreasonable as a matter of law. They contend that the auditor's methodology was not reasonably calculated to determine the correct amount of tax due and, thus, lacked a rational basis.

In support of their argument, petitioners point to the fact that the auditor initially performed a third-party markup that resulted in a taxable sales amount that was significantly less than the amount resulting from the use of the rent factor. They claim that the auditor was unable to fully explain the rationale for changing methodology and that the change led to unreasonable results demonstrating that the auditor's reasoning was irrational. Petitioners also take issue with the particular rent index used by the auditor, claiming that it resulted in additional sales tax due that was significantly higher than what would have been due had the Division used the Almanac. They assert that the auditor's computation unreasonably assumes that all sales (other than food stamp sales) were taxable.

With regard to penalties, petitioners argue that any omissions in tax were due to reasonable cause and not willful neglect. They state that they did not deliberately refuse to produce books and records. They contend that they produced, or were in the process of producing, everything in their possession in response to the requests made by the Division, however, many of the books and records requested by the Division were never created or maintained by petitioners. Petitioners argue that the Division failed to include in the audit record copies or transcriptions of many of the documents that were submitted by petitioners. They claim that the imposition of penalties is unwarranted given that they began maintaining cash register tapes as early as March 2014, but were not able to upgrade their point of sale (POS) system to record the detail itemized register tapes until January 2015.

Lastly, regarding the audit overall, petitioners claim that the audit was “marred” by both incompetence and overreaching on the part of the auditors. They claim that the auditor responsible was a trainee with no experience and Silver Saddle was her first audit. Furthermore, they claim the Division overreached on several occasions by sending agents to harass, intimidate and elicit statements and documents from petitioners without notifying their attorney.

The Division argues that petitioners have failed to come forward with clear and convincing evidence to prove that the assessment or the audit methodology was erroneous and that, therefore, the exception should be denied. It asserts that petitioners failed to maintain sufficient books and records to establish the correct amount of sales tax due and are attempting to prove their tax liability by simply presenting their own lower estimate of tax due.

The Division contends that it was authorized to estimate the tax due since petitioners failed to produce adequate books and records to verify all transactions. The Division asserts that its auditors selected an audit methodology that reasonably calculated the tax due and that

exactness was not required when it was petitioners' own failure to maintain books and records that prevented the assessment from being exact. With regard to the specific methodology used, the Division asserts that the use of a rent factor was reasonable. The Division states that it selected the rent factor most closely aligned to petitioners' business. It claims that it identified the statistical report from which the rent factor was derived and that its auditors responded to petitioners' inquiries at hearing and explained why they chose that particular methodology and report.

The Division argues that penalties should not be abated since petitioners have offered no evidence to establish that the failures to properly report and pay tax were due to reasonable cause and not due to wilful neglect. The Division asserts that petitioners disregarded the requirements of the Tax Law by failing to maintain and produce adequate books and records to determine taxable sales. It claims that this is so even though the business had been audited before and petitioners were fully aware of the Tax Law requirements. The fact that petitioners began to maintain records for periods subsequent to the audit period is irrelevant and does not establish reasonable cause for the period at issue, according to the Division.

OPINION

Persons required to collect tax, including petitioners here, must "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" (Tax Law § 1135 [a] [1]). Among other items, the records must contain a true copy of each "sales slip, invoice, receipt . . . cash register tape and other original sales document" (20 NYCRR 533.2 [b] [1] [i] [iii]). Further, those records must be sufficient to verify all transactions; kept in a manner suitable to determine the correct amount of tax due; and available for the Division's inspection

and examination upon request for a period of three years (Tax Law §§ 1135 [g], 1142 [5]; 20 NYCRR 533.2 [a] [1] [2]; *see Wolkowicki v New York State Tax Appeals Trib.*, 136 AD3d 1223 [3d Dept 2016]).

Tax Law § 1138 (a) (1) provides in relevant part that if a sales tax return is 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” The standard for the use of external indices is well established. Specifically, the Division must first make an explicit request for the taxpayer’s books and records (*Matter of Christ Cella, Inc. v State Tax Commn.*, 102 AD2d 352 [3d Dept 1984]) for the entire audit period of the assessment (*Matter of Adamides v Chu*, 134 AD2d 776 [3d Dept 1987], *lv denied* 71 NY2d 806 [1988]). The Division must then undertake a sufficient investigation of the materials provided by the taxpayer in order to determine whether such materials are capable of supporting a complete audit (*Matter of King Crab Rest. v Chu*, 134 AD2d 51, 53 [3d Dept 1987]). Where such review indicates that the records are so insufficient that it is virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit from which the exact amount of tax due can be determined, then the Division may resort to the use of external indices to estimate tax (*Matter of W. T. Grant Co. v Joseph*, 2 NY2d 196 [1957], *rearg denied* 2 NY2d 992 [1957], *cert denied* 355 US 869 [1957]). When estimating sales tax, the Division must adopt an audit method reasonably calculated to determine the amount of tax due (*id.*). Exactness in the amount of tax is not required where the taxpayer’s own failure to maintain records prevents it (*id.*). The burden is then on the taxpayer to demonstrate by clear and convincing evidence that the result of the audit method employed was

unreasonably inaccurate or that the amount of the tax assessed is erroneous (*Matter of Meskouris Bros. v Chu*, 139 AD2d 813 [3d Dept 1988]).

An application of the foregoing principles to the facts in this matter makes clear that the Division's use of an indirect audit method was proper. As the Administrative Law Judge detailed, the Division made several clear and explicit requests for a complete set of Silver Saddle's records pertaining to sales and use tax liability for the audit period (*see* findings of fact 2, 7, 12 and 18). Between July 31 and December 2, 2014, the Division sent a total of five IDRs to petitioners or petitioners' representative, conducted a field survey of the business and conducted three field audit visits at the representative's office. The Administrative Law Judge determined, and we agree, that despite the repeated requests for records, petitioners maintained and made available only limited records, which were clearly not adequate for purposes of conducting an audit to determine the accuracy of Silver Saddle's sales tax returns as filed. Particularly, petitioners did not maintain source records of sales, such as sales slips, sales invoices, receipts, cash register tapes, or other original sales documents that would disclose the amount of Silver Saddle's taxable and gross sales and the amount of sales tax collected from its customers during the audit period as required (*see* 20 NYCRR 533.2 [b] [1] [i], [iii]). Additionally, petitioners' purchase records were incomplete and petitioners' cash register could not itemize the type of goods sold. Also, petitioner Musaed could not remember how his accountant determined the amount of sales tax to report on the business' sales tax returns (*see* finding of fact 3).

It is also quite clear from the record that the auditor reviewed and considered the documents and records that were provided by petitioners as required (*see* findings of fact 11, 13, 24 and 25; *Matter of King Crab Rest. v Chu*). Although petitioners argue that they submitted

Silver Saddle's books and records, they do not contest the finding that such books and records were inadequate to conduct a detailed audit. Nor do they contest that the Division was justified in resorting to an indirect method to determine Silver Saddle's sales and sales tax liability. Rather, petitioners' complain that the audit file introduced into evidence was missing critical records, including those submitted by petitioners during the audit and some of the auditor's work papers. The auditor and her supervisor adequately explained at hearing that all of the documents and records submitted by petitioners were reviewed and included in the audit file or "main" file, even though certain documents were not introduced into evidence at hearing. The auditor further explained that the workpapers relating to the third-party mark-up estimate were not included in the audit file introduced at hearing because the third-party mark-up estimate was rejected in favor of an assessment based on the use of the rent index. Hence, contrary to petitioners' contentions, the record in this case supports the conclusion that the documents and records provided were reviewed and considered by the auditor and found to be inadequate. Consequently, this portion of petitioners' argument is rejected (*see Matter of Karay Rest. Corp.*, Tax Appeals Tribunal, December 10, 1998, *confirmed* 274 AD2d 854 [2000], *lv denied* 96 NY2d 702 [2001]).

Petitioners' main contention is that the particular method used was arbitrary and capricious and rendered the computation of taxable sales unreasonable as a matter of law. Petitioners assert that the auditors did not provide a reasonable basis for the rejection of the initial indirect method, the third-party mark-up. Petitioners claim that the initial method was closely tied to their records and consistent with the methodology used in a prior audit of petitioners' sales tax returns. Petitioners further assert that the auditor could not competently describe the basis for the rent factor methodology and could not articulate whether the missing

purchase records reasonably warranted the change from the mark-up methodology that, ultimately, resulted in an increased determination of sales.

Regarding the IRS Ratios index, specifically, petitioners assert that it uses unreasonably broad asset-size categories. They claim that the Almanac is regularly used by the Division in grocery/deli audits and has narrowly tailored asset-size categories that would have more closely approximated petitioners' actual sales. Petitioners also claim that the auditors ignored the disclaimer in the introduction to the IRS Ratios, which warns of distortion of data and sought only to cherry pick a factor that would yield the greatest tax due. Petitioners also take issue with the fact that the Division's methodology and assessment made no reasonable allowance for nontaxable sales of groceries, other than those purchased with food stamps.

Where, as here, petitioners fail to keep such records as would be sufficient to complete a sales tax audit, "the Division has the latitude to choose the method it feels best accomplishes its goal of reasonably estimating petitioners' tax liability" (*see Matter of 33 Virginia Place, Inc.*, Tax Appeals Tribunal, December 23, 2009). We have previously determined that the Division may estimate taxable sales based on the taxpayer's rent (*see Matter of New Intrigue Jewelers, Inc.*, Tax Appeals Tribunal, March 6, 2014 (retail jewelry kiosk); *Matter of Constantini*, Tax Appeals Tribunal, January 10, 2008 (pizzeria); *Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003 (grocery/convenience store); *Matter of Henry Street Superior Deli Corp.*, Tax Appeals Tribunal, February 21, 2017 (deli); *Matter of J&L Donut Shop, Inc.*, Tax Appeals Tribunal, September 13, 2012 (restaurant). We have noted that "the key to approval of a rent factor in an audit is the identification in the record of the statistical report from which the rent factor is derived (*Matter of Bitable on Broadway*, Tax Appeals Tribunal, January 23, 1992, *confirmed sub nom. Matter of Bitable on Broadway v Wetzler*, 199 AD2d 633 [3d Dept 1993]).

This allows the taxpayer both the opportunity to review the report and the ability to introduce evidence to challenge the soundness or applicability of the report (*id.*). Further, 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 Basilio*, Tax Appeals Tribunal, May 9, 1991).

After considering the facts and law in this matter, we do not agree with petitioners' assertion that the Administrative Law Judge was incorrect in her conclusion that the Division's application of the IRS Ratios index had a rational basis. The Division's auditors clearly described the use of the rent factor and the reason why they chose that methodology and the IRS Ratios index, in particular. The Administrative Law Judge noted that the auditor sent third-party verification letters in an attempt to obtain information regarding petitioners' purchases during the audit period (*see* findings of fact 5 and 9). The auditor initially attempted to calculate the appropriate amount of tax for the period using information provided by petitioners and available third-party information for beer, beverage and cigarette purchases and applying a mark-up taken from the Almanac (*see* finding of fact 11). The auditor's program manager, however, rejected that approach as incomplete because it did not include purchase information for other items sold in the store.

Lacking sufficient records regarding sales and purchases, the auditor and her supervisors determined that it was necessary to use another audit methodology to calculate taxable sales and decided to obtain the business' lease agreement or canceled rent checks in order to calculate taxes based on a rent factor (*see* finding of fact 11). Contrary to petitioners' contention, given the lack of records, we find that the Division's rejection of the mark-up method in favor of the

rent factor was rational. Thereafter, the Division's auditors used the IRS Ratios index and the business' rent expense information obtained from the lease to determine if additional tax was due for the period under review (*see* finding of fact 15). The auditor explained at hearing that the IRS Ratios index was used rather than the Almanac because the Almanac required information regarding deductible expenses, such as bad debts, maintenance, and repairs, which was not provided by petitioners (*id.*). In applying the rent index to determine the amount of the gross sales, the auditor selected the rent expense to sales ratio in the food and beverage stores category for petitioners' business (*see* finding of fact 16). Within that category, the auditor selected the category for profitable businesses with asset values between \$1,000.00 and \$999,999.00 (*id.*). The auditor determined the category based on her visual observation of the business, available purchase information and the taxable sales reported on the business' sales tax returns (*id.*). The auditor's category selection was found to be correct once information in the federal income tax returns became available.

The Administrative Law Judge also noted and described the auditor's application of Silver Saddle's nontaxable food stamp sales, which totaled \$96,769.39 (*see* findings of fact 16 and 27). Petitioners argue that it was unreasonable for the Division to not make some allowance for other nontaxable grocery sales. They point to the third party purchase information received from "Krasdale," which the auditor testified sells both taxable and nontaxable items. Although the third-party mark-up estimate was not ultimately used, the auditor's third party purchase information worksheet on pages 167-168 of exhibit "L" shows that purchases from Krasdale during the audit period totaled \$46,909.51. The worksheet also shows that purchases of beer, beverages and cigarettes totaled \$1,016,132.95. Accordingly, even if all of the purchases from Krasdale were deemed to be nontaxable items, they amounted to just four percent of the total

third party purchases calculated by the auditor (\$46,909.51/\$1,063,042.16). Given such a small percentage and considering that petitioners failed to provide any records or evidence to establish nontaxable sales and refused to consent to an observation of the business, we must agree with the Administrative Law Judge's conclusion that petitioners' claim regarding nontaxable sales in addition to food stamp sales must be denied (*see Matter of Sol Wahba, Inc. v New York State Tax Commn.*, 127 AD2d 943 [3d Dept 1987]; *Matter of J&L Donut Shop*).

We also find that petitioners' contention that the auditors ignored the disclaimer in the IRS Ratios index that warned of distortion of data lacking merit. The Administrative Law Judge noted that the IRS Ratios index is based on statistical data derived from a sample of over 145,000 corporation tax returns filed with the IRS (*see* finding of fact 16). The disclaimer appears to be standard language and is, in fact, similar to language included in the introductory pages of the Almanac.¹ The statistical report was clearly identified and was subject to examination by petitioners. The Division's auditors responded meaningfully to questions regarding the nature of the audit such that petitioners had an opportunity to meet their burden of proof and the Administrative Law Judge had sufficient evidence to determine whether the audit had a rational basis (*Matter of Basilio*). We do not agree that the supervisor's testimony regarding the relevancy of the distortion in the IRS Ratios data rendered the use of the report unreasonable (*see Matter of 33 Virginia Place, Inc.*). Further, it has been established that the rent factor used by

¹ IRS Ratios disclaimer: ". . . The fact that a consolidated corporation return was assigned a single industry code constitutes a distortion of the data. Some consolidated (and nonconsolidated) corporations engage in many types of business activities. There are some data in each industry that are not really related to the industrial activity under which they are shown" (exhibit 7 p 7).

2015 Almanac disclaimer: "The source of the IRS's data are the tax returns of all active public and private corporations The tax returns are classified by the IRS on the basis of the business activity which accounts for a corporation's largest percentage of total receipts. Large corporations with dissimilar business activities are included in only one industry, despite operations that are unrelated to the industry in which they are grouped" (exhibit 1 p ix).

the auditors (3.94%) was the most appropriate given the amount of information that was available to the auditors. The method selected by the Division was reasonably calculated to determine the amount of tax due and any imprecision in the results of the audit from using a standard index arises by reason of petitioners' own failure to keep and maintain records of all of its sales as required by the Tax Law and must be borne by petitioners (*see Matter of Markowitz*, 54 AD2d 1023 [3d Dept 1976]).

Petitioners' assertion that the application of a different index (i.e., the Almanac), or a different rent factor from the IRS Ratios index, would have resulted in a different amount of tax due does not necessarily mean that the Division was not acting rationally when it chose the rent factor used and that the audit methodology overall lacked a rational basis. Petitioners cannot invalidate the Division's audit by offering their own estimate of tax liability as a substitute for the Division's (*see Matter of Albanese Ready Mix*, Tax Appeals Tribunal, June 15, 1989).

Petitioners here have the burden of proving by clear and convincing evidence that the "methodology was not merely imprecise but unreasonably inaccurate and the tax assessed erroneous" (*Matter of Shukry v Tax Appeals Trib. of State of N.Y.*, 184 AD2d 874, 876 [3d Dept 1992]). We agree with the Administrative Law Judge that petitioners have not carried that burden (*see Matter of Meskouris Bros. v Chu*).

As to petitioners' challenge to the penalties imposed by the Division, Tax Law § 1145 (a) (1) (i) requires that a penalty shall be imposed upon any person failing to file a return or pay over any sales or use tax. Tax Law § 1145 (a) (1) (vi) similarly requires that any person who underreports greater than 25% of the total sales tax due shall be liable for a penalty. These penalties must be sustained unless petitioners demonstrate that the failure to pay or the underreporting of sales tax was due to reasonable cause and not due to willful neglect (Tax Law

§ 1145 (a) (1) (iii); 20 NYCRR 2392.1; *see Matter of MCI Telecom. Corp.*, Tax Appeals Tribunal, January 16, 1992, *confirmed Matter of MCI Telecom. Corp. v New York State Tax Appeals Trib.*, 193 AD2d 978 [3d Dept 1993]).

As mentioned above, taxpayers have an affirmative duty to retain such records as necessary for the Division to determine the amount of sales and use tax due (Tax Law § 1135 [a] [1]; 20 NYCRR 533.2). The Administrative Law Judge found that petitioners failed to make adequate books and records available for audit and substantially underreported and underpaid tax due. She found petitioners' contention that they began to maintain detailed sales records for periods subsequent to the audit period irrelevant and insufficient to establish reasonable cause for the abatement of penalties in this proceeding. The Division's regulations provide that "[i]n determining whether reasonable cause and good faith exist, the most important factor to be considered is the extent of taxpayer's efforts to ascertain the proper tax liability" (20 NYCRR 2392.1 [g] [2]). Petitioners' failure to create and maintain records as required by Tax Law § 1135 (a) (1) is indicative of wilful neglect and supports the imposition of penalties (*see Matter of Lima Florists*, Tax Appeals Tribunal, December 15, 1988). We agree with the Administrative Law Judge that petitioners have not established reasonable cause for abatement of penalties in this matter. The facts reveal that petitioners did not have a cash register that could itemize taxable and nontaxable sales and did not create any other method for keeping records that would accurately reflect the tax collected and due. We also agree with the Administrative Law Judge's determination that petitioners' recent efforts to document taxable sales and maintain records does not establish reasonable cause for their failure to keep reliable sales records for the period at issue. Thus, we conclude that the determination of the Administrative Law Judge to sustain the imposition of penalties arising under Tax Law § 1145 on petitioners was not in error.

Finally, we find no evidence to substantiate petitioners' claim of incompetence or overreaching on the part of the Division's auditors. While this was one of the principal auditor's first assignments, the record clearly establishes that she was closely supervised by more experienced auditors, a team leader and a program manager and that they were closely involved in the decision making for this audit.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Silver Saddle Deli Grocery, Inc. and Amir Musaed is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Silver Saddle Deli Grocery, Inc. and Amir Musaed are denied; and
4. The notices of determination dated December 5, 2014, December 8, 2014,

February 24, 2015 and February 25, 2015 are sustained.

DATED: Albany, New York
April 25, 2019

s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner

/s/ Anthony Giardina
Anthony Giardina
Commissioner