

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
EDELWEISS CATERING, INC.	:	DETERMINATION
	:	DTA NOS. 825911
	:	AND 825963
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 February 29, 2012.	:	

Petitioner, Edelweiss Catering, Inc., filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2005 through February 29, 2012.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, in New York, New York, on February 17, 2015, at 10:30 A.M., with all briefs to be submitted by May 27, 2015, which date began the six-month period for the issuance of this determination. Petitioner appeared by its president, Juergen Staeckeler. The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K. Jack, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation clearly requested and, in turn, received from the petitioner books and records that were sufficient for the conduct of a direct audit.

II. Whether, if sufficient books and records were not provided, petitioner has nonetheless established that the indirect audit methodology utilized by the Division of Taxation was not reasonably calculated to reflect the correct amount of tax due, or that there were errors made in the application of such audit methodology.

III. Whether petitioner has established any bases justifying reduction or cancellation of the penalties assessed.

FINDINGS OF FACT

1. Petitioner, Edelweiss Catering, Inc., operated a delicatessen located in Yaphank, New York, during the period March 1, 2005 through February 29, 2012. Petitioner sold hot and cold prepared food, sandwiches, wraps, salad dishes, pastries, chips, snacks and beverages.

Petitioner's premises are located inside a free-standing building and include a pastry display, four chip racks, a large cold salad case, a four-door refrigerator for beer, a seven-door refrigerator for other cold beverages and five chafing (steam) tables for hot foods. There were two tables with benches located outside of the premises, but no inside seating. Food delivery was available, and the deli also provided catering. Petitioner was open seven days per week between the hours of 6:00 A.M and 5:00 P.M. on Monday through Friday, 7:00 A.M. and 3:00 P.M. on Saturdays and 7:00 A.M. to 2:00 P.M. on Sundays. Petitioner filed its sales and use tax returns on a quarterly basis.

2. There are two audit periods at issue in this matter, and each will be discussed in turn.

The First Audit Period - March 1, 2005 through November 30, 2007¹

3. By an appointment letter dated January 29, 2008, the Division of Taxation (Division) notified petitioner that its New York State sales and use tax records had been scheduled for a field audit for the period March 1, 2005 through November 30, 2007 (the first audit period).

The Division's audit appointment letter explained that all books and records pertaining to petitioner's sales and use tax liability for the noted period must be available on the audit

¹ By an Order dated July 31, 2014, an initial challenge to the timeliness of the petition filed for this period was resolved in petitioner's favor.

appointment date of February 26, 2008. Among the records specifically requested, in an attached Records Requested List, were sales tax returns, worksheets and cancelled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; all exemption documents supporting nontaxable sales; chart of accounts; fixed asset purchase/sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips for all accounts; cash receipts journal and sales journal; cash disbursements journal and purchase journal; the corporate book, including minutes, board of directors and articles of incorporation; depreciation schedules; copies of leases; SLA license; lease contracts; utility bills; guest checks; and cash register tapes for the entire audit period.

4. In response to the foregoing, petitioner's then-representative provided to the auditor petitioner's accountant's worksheets listing monthly gross receipts, cash payroll and total receipts, and petitioner's daybook sheets listing daily sales receipts (excluding cash register tapes). Subsequently, petitioner's then-representative provided a few cash register tapes. The type of cash registers used by petitioner do not identify or describe the individual items being sold, but rather only indicate the dollar amount of the sale and whether the sale is rung into the register as taxable or nontaxable.

5. The auditor's review of the foregoing documents confirmed that petitioner did not maintain detailed records of its sales, including detailed cash register tapes or other source documents identifying individual sales or items sold, or the taxable versus nontaxable status of any of such individual items. Accordingly, the auditor concluded that the books and records were inadequate to conduct a complete audit so as to verify gross sales or the taxable status of any of petitioner's sales. The auditor sent correspondence to petitioner dated July 25, 2008,

informing petitioner that its books and records were insufficient and that it would be necessary to perform a full-day observation at petitioner's premises.

6. The Division's auditor performed an observation of the deli's sales on Thursday, August 7, 2008. The observation began at the opening of the deli at 6:00 A.M. and continued until the deli's closing at 5:00 P.M. According to the Division's audit report, the observation test disclosed total gross receipts for the day of \$2,468.22, consisting of total taxable sales in the amount of \$1,982.52 and nontaxable sales of \$485.70.² The auditor reduced total taxable sales by the amount of sales tax included therein to arrive at net taxable sales of \$1,825.10, which together with nontaxable sales (\$485.70), resulted in adjusted gross sales of \$2,310.80. In turn, the auditor compared taxable sales (\$1,825.10) to adjusted gross sales (\$2,310.80), to arrive a taxable sales ratio of 78.98 percent.

7. The auditor multiplied petitioner's audited net taxable sales per the observation results (\$1,825.10) by 91 days per sales tax quarterly period, and in turn multiplied the resulting quarterly net taxable sales amount by the 11 quarterly periods within the subject audit period, to arrive at audited taxable sales of \$1,826,925.10. The auditor reduced such amount by taxable sales reported per petitioner's sales and use tax returns (\$637,073.00), to arrive at additional taxable sales of \$1,189,852.10, with sales tax due thereon in the amount of \$102,224.21.

8. On March 2, 2009, the Division issued to petitioner a Notice of Determination assessing additional sales and use tax due for the period March 1, 2005 through November 30, 2007 in the amount of \$102,224.21, plus interest and penalty.

² Notwithstanding the auditor's observation that patrons placed catering orders on the date of the observation, the Division did not include any amounts for catering sales in its computation of total sales.

The Second Audit Period - December 1, 2007 through February 29, 2012

9. By letters dated September 2, 2010, addressed to petitioner, and December 9, 2010, addressed to petitioner's then-representative, the Division notified petitioner that its New York State sales and use tax records had been scheduled for a field audit for the period December 1, 2007 through May 31, 2010. This period was thereafter extended to February 29, 2012 (the second audit period).³ As was the case with the first audit period, the Division's audit appointment letters explained that all books and records pertaining to petitioner's sales and use tax liability for the audit period must be made available for audit and, as before, included an attached records required list specifying such records (*see* Finding of Fact 3).

10. In response to the foregoing, petitioner's then-representative met with the auditor on February 15, 2011 and provided petitioner's bank statements and general ledger for a portion of the audit period (2008 and 2009), plus three boxes of purchase invoices that were reviewed but deemed by the auditor not to be in auditable condition. No cash register tapes or other documents concerning petitioner's sales were provided. The auditor provided petitioner's then-representative with a list of items needed to complete the audit.

11. Between July 2011 and September 2011, three boxes of rolls of cash register tapes pertaining to the second audit period, and one box of rolls of cash register tapes pertaining to the first audit period were provided to the auditor for review. The auditor's review of these tapes revealed that petitioner continued to use the same cash registers as were in use during the first audit period, and that such registers and the tapes they generated did not identify or describe the

³ By a letter dated April 20, 2012, the Division advised that the audit period was expanded such that it would encompass, in total, the period December 1, 2007 through February 29, 2012. In the course of its audit, the Division obtained from petitioner a series of executed consents pursuant to which the period of limitations on assessment was extended to December 20, 2012.

individual items being sold, but rather only indicated the dollar amount of the sale and whether the sales were rung into the register as taxable or nontaxable. The auditor further noted that there were two cash registers at petitioner's premises, but he was unable to discern if both were used since the tapes both refer to register "1" and clerk "1." The auditor further noted that there were some gaps where there were missing rolls of tapes, some instances where a register tape appeared to cover multiple days, and that there were many "no sale" listings on the tapes, indicating that the register drawer was opened and closed without any listed transaction on the tape. Petitioner attributed these latter "no sale" listings to instances where one or the other of the two cash registers was opened only for the purpose of obtaining change or small bills, as needed, between the two registers.

12. The auditor's review of the foregoing documents for the second audit period confirmed that petitioner did not maintain detailed records of its sales, including detailed cash register tapes or other source documents identifying individual sales or items sold, or the taxable versus nontaxable status of any of such individual items. Accordingly, the auditor concluded that the books and records were inadequate to conduct a complete audit so as to verify gross sales or the taxable status of any of petitioner's sales.

13. The Division's auditor utilized the results of the Division's August 7, 2008 observation of the deli's sales, and applied the same method of calculation as was used for the first audit period, to compute petitioner's tax liability for the second audit period (*see* Findings of Fact 6 and 7).⁴ Specifically, by such method, the auditor computed audited taxable sales (\$3,023,509.31), reduced such amount by taxable sales reported per petitioner's sales and use tax

⁴ It is noted that the date of the observation (August 7, 2008) occurred during the second audit period herein.

returns (\$1,154,260.00), and thus arrived at additional taxable sales (\$1,869,249.31), with sales tax due thereon in the amount of \$161,222.74.

14. On May 25, 2012, the Division issued to petitioner a Notice of Determination assessing additional sales and use tax due for the period December 1, 2007 through February 29, 2012 in the amount of \$161,122.74, plus interest and penalty.

SUMMARY OF PETITIONER'S POSITION

15. For each quarterly period, petitioner maintains that it reduced its gross sales, per its day books, by its estimate that 30 percent of such sales were nontaxable sales, and furnished such reduced amount to its accountant for purposes of preparing petitioner's sales and use tax returns. Petitioner claims its accountant was under the assumption that petitioner was providing its gross sales amount, and in turn he reduced the dollar amount reported to him by petitioner by another 30 percent as an estimate of petitioner's nontaxable sales included in its gross sales. As a consequence, petitioner's reported tax liability was based on only 40 percent of its day book amount of gross sales. Petitioner's accountant submitted a proposed recalculation of liability, premised upon reducing petitioner's day book amount of gross sales by 30 percent (but only once) representing an estimate of petitioner's nontaxable sales. Under this calculation, petitioner would admit to a liability of \$27,341.00 for the first audit period and \$30,992.00 for the second audit period.

CONCLUSIONS OF LAW

A. The standard for reviewing a sales tax audit where an indirect audit methodology has been employed in the determination of sales tax liability is well established, and was set forth in *Matter of AGDN, Inc.* (Tax Appeals Tribunal, February 6, 1997), as follows:

“a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained ‘shall include a true copy of each sales slip, invoice, receipt, statement or memorandum’ (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, ‘the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ’ (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43).

When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (*Matter of Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869); exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).”

B. In this case, the record establishes the Division’s clear and unequivocal written request for books and records of petitioner’s sales. In turn, the records provided by petitioner were clearly not sufficient for determining whether petitioner’s sales were correctly reported, either as to its total sales or, specifically, as to its reported taxable sales versus its nontaxable sales. In this respect, petitioner did not maintain or produce sales invoices or receipts, including cash register receipts, identifying in any manner the items sold in each transaction. As a consequence, on audit the Division was unable to confirm that petitioner’s reported nontaxable sales were, in fact, not subject to tax. The Division reasonably concluded that petitioner did not maintain or have available books and records that were sufficient to verify gross and taxable sales for the audit period.

C. Having established the inadequacy of required books and records, the Division was clearly entitled to resort to the use of indirect methods, including the use of an observation test, to determine petitioner's sales and sales tax liability (*see Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 204 [1957], *cert denied* 355 US 869 [1957]; *Matter of Del's Mini Deli, Inc. v. Commr. of Taxation and Finance*, 205 AD2d 989 [1994]; *Matter of Vebol Edibles v. Tax Appeals Tribunal*, 162 AD2d 765 [1990], *lv denied* 77 NY2d 803 [1991]). The Division is under no obligation to utilize one indirect method of audit as opposed to another, but rather must only select a method of audit reasonably calculated to determine the amount of tax due (*Matter of W. T. Grant Co. v. Joseph*). Indeed, the use of a one-day observation test has been specifically addressed and approved (*see Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878 [1992]). Further, the law is clear that the results of a one-day observation test may reasonably be extrapolated over a multiple-year audit period (*Matter of Marte*, Tax Appeals Tribunal, August 5, 2004). The use of the one-day observation test performed by the Division to determine petitioner's gross and taxable sales for the audit periods was a methodology well suited to the circumstances such as the present, where petitioner failed to maintain adequate source documentation of the taxable status of its sales, and is supported by a large body of case law. (*See e.g. Matter of Lombard v. Commr. of Taxation & Fin.*, 197 AD2d 799 [1993] [one-day observation test]; *Matter of Club Marakesh v. State Tax Commn.*, 151 AD2d 908 [1989], *lv denied* 74 NY2d 616 [1989] [one-day observation test].) Any imprecision in the results of an audit arising by reason of a taxpayer's own failure to keep and maintain records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (*Matter of Markowitz v. State Tax Commission; Matter of Meyer v. State Tax Commn.*).

D. Since it is concluded that the audit method was reasonable, petitioner had the burden of proof to show, by clear and convincing evidence, that the result of the audit was unreasonably inaccurate or that the amount of tax assessed was erroneous (*Matter of Sarantopoulos*). Petitioner failed to meet this fairly substantial burden (*see Matter of Center Moriches Monument Co. v. Commr. of Taxation & Fin.*, 211 AD2d 947 [1995]). The minimal amount of evidence produced falls far short of meeting this burden. There is no evidence in the record to support petitioner's argument that the day of the week on which the observation test was conducted, a Thursday, was not reflective of petitioner's normal daily sales. More importantly, petitioner itself did not rely upon its own records, including its cash register tapes, to determine and report its claimed nontaxable sales, but rather admitted that the same were reported based simply upon estimation, i.e., that 30 percent of petitioner's sales were non-taxable sales. In fact, the Division's observation of petitioner's sales revealed that this estimate was erroneous. It is therefore difficult to accept complaints about the Division's resort to estimated audit methodologies, or the alleged inaccuracies therein, when petitioner itself utilized estimation as its method of reporting and filing. In view of the circumstances, petitioner has not established either that the method of audit was unreasonable or that there were mistakes in the Division's application of such method so as to result in errors in the amount of tax determined thereby.

E. Finally, the Division's imposition of penalties in this matter is sustained. Petitioner's argument concerning a misunderstanding between it and its accountant bears out petitioner's significant underreporting of its taxable sales (*see* Finding of Fact 15). In fact, petitioner's accountant's proposed recalculation of liability itself admits to a significant deficiency, albeit less than that determined by the Division on audit. On this score, there is no evidence that petitioner reviewed its returns or raised any question over what would appear to be an obvious indication

that its reported taxable sales were understated (i.e., that the same represented only 40 percent of its total sales). Further, such purported miscommunication does not address, impact or overcome petitioner's record keeping failures, or provide any basis for the abatement of penalties premised thereon.

F. The petitions of Edelweiss Catering, Inc., are hereby denied and the notices of determination dated March 2, 2009 and May 25, 2012 are sustained.

DATED: Albany, New York
November 12, 2015

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE