

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
GOLDEN BRIDGE II, INC. : DETERMINATION
 : DTA NO. 826641
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 June 1, 2009 through February 29, 2012. :

Petitioner, Golden Bridge II, Inc., 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 June 1, 2009 through February 29, 2012.

A hearing was held before Barbara J. Russo, Administrative Law Judge, in New York, New York, on December 15, 2015 at 10:30 a.m., with all briefs to be submitted by April 6, 2016, which date began the six-month period for the issuance of this determination. Petitioner appeared at the hearing by Michael Buxbaum, CPA, and subsequent to the hearing was represented by Marti & Associates, Inc. (Yesenia Santana). The Division of Taxation appeared by Amanda Hiller, Esq. (David Gannon, Esq., of counsel).

ISSUES

I. Whether the audit methodology utilized by the Division of Taxation in its audit of Golden Bridge II, Inc., had a rational basis and was reasonably calculated to reflect the tax due.

II. Whether petitioner has shown reasonable cause for the abatement of penalties.

FINDINGS OF FACT

1. During the period at issue Golden Bridge II, Inc., (petitioner), was a grocery/deli in Central Islip, New York, that sold prepared food including hot buffet items, cigarettes, lottery tickets, and other food and drink items such as milk, beer, soda, juice, water, coffee, tea, deli meat and cheese, chips and cookies. The business had a dine-in area with tables and chairs.

2. By appointment letter dated April 9, 2012, the Division of Taxation (Division) confirmed that petitioner was scheduled for a field audit of its New York State sales and use tax records for the period June 1, 2009 through February 29, 2012. The letter further explained that all books and records pertaining to sales and use tax liability for the audit period must be available for the appointment.

3. On June 14, 2012, the Division's auditor met with petitioner's representative, Ana Rios, who provided bank statements, handwritten check slips, some purchase invoices, federal returns for 2009, 2010 and 2011, and a print out of sales tax returns totals. Ms. Rios informed the auditor that petitioner did not have electronic records or cash register tapes and that petitioner determined daily sales by subtracting the amount in the cash register drawer at the beginning of the day from the amount in the drawer at the end of the day.

4. Following her review of the available documentation, the auditor concluded that the books and records were inadequate to conduct a complete audit for the audit period because petitioner did not maintain original source documentation, such as cash register tapes, daybooks or a general ledger, and purchase invoices were missing. The auditor determined that sales could not be traced, there were no internal controls, and it was impossible to determine what portion of petitioner's sales were nontaxable.

5. Due to the inadequacy of petitioner's records, the Division's auditor determined that a full day observation test would be performed. The observation test was conducted on Thursday, September 13, 2012, by three Division investigators who each observed a shift, the first from the business opening at 5:30 a.m. until noon, the second from noon to 3:00 p.m., and the third from 3:00 p.m. to closing at 9:30 p.m. Utilizing a worksheet template and common abbreviations, the investigators recorded gross receipts; taxable and nontaxable sales; cash, credit card and benefit card usage; and customer traffic.

6. The observation test disclosed gross receipts for the day of \$2,974.87, which included prepared food and other taxable sales of \$2,678.46, and nontaxable sales of \$296.41.

7. Utilizing the information collected during the observation test, the auditor computed additional tax due. The auditor started the calculation with gross receipts pursuant to the observation test in the amount of \$2,974.87. From this amount she subtracted nontaxable sales in the amount of \$296.41, to arrive at taxable receipts of \$2,678.46 for the observation day. From this amount the auditor subtracted sales tax to determine taxable sales net of tax in the amount of \$2,465.79. The auditor next computed the average daily taxable sales based on returns filed by petitioner. She began with petitioner's reported taxable sales for the quarter ending November 30, 2011, being the closest comparable quarter. Petitioner's reported taxable sales for that period were \$30,127.00. The auditor then divided the \$30,127.00 by 91 (the number of days in the quarter) to arrive at average daily taxable sales of \$331.07.

The auditor then computed the additional unreported taxable sales. She began by subtracting the average daily taxable sales reported per the taxpayer's comparable sales tax return of \$331.07 from the taxable sales identified via the observation test in the amount of \$2,465.79, resulting in a difference of \$2,134.72. The auditor then computed the margin of error by dividing

the additional unreported taxable sales from the observation day of \$2,134.72 by the average taxable sales reported of \$331.07, resulting in an error rate of 644.80%. The auditor then multiplied the error rate of 644.80% by the taxable sales reported by petitioner for the entire audit period in the amount of \$337,353.00, to calculate additional taxable sales for the entire audit period in the amount of \$2,175,259.16.¹ The auditor applied the applicable sales tax rate of 8.625% to the additional taxable sales for the audit period of \$2,175,259.16 to calculate additional tax due for the audit period in the amount of \$187,616.10.

8. The auditor further noted that while petitioner reported a taxable ratio of approximately 40%, the taxable ratio for the observation day was 89%.

9. The auditor also compiled and analyzed third-party information during the course of the audit. Specifically, the auditor identified supplier addresses from the partial collection of purchase invoices provided by petitioner's representative and sent verification letters to the suppliers. A number of suppliers did not respond to the auditor's request for information. Because the supplier-provided information was incomplete, the computation of total purchases made by petitioner was likely lower than it would have been had all suppliers responded. The auditor compared the data provided by the responding suppliers to petitioner's federal tax returns for the audit period and determined that there were significant discrepancies in petitioner's tax filings. Specifically, for 2011, petitioner reported purchases of \$141,723.00 on its federal return, but the information collected from suppliers showed purchases of \$336,904.70. For 2010, petitioner reported purchases of \$164,641.00 on its federal return, but the information collected from suppliers showed purchases of \$262,505.79.

¹ It is noted that while the Division's workpapers and the auditor's testimony state that taxable sales pursuant to the calculation total \$2,175,259.16, the actual amount should be \$2,175,252.10 ($644.80\% \times 337,353 = 2,175,252.10$). There was no explanation for the discrepancy. Said difference is deemed inconsequential.

10. The Division issued a Notice of Determination, dated January 30, 2014, to petitioner asserting additional sales and use tax due of \$187,616.10 for the period June 1, 2009 through February 29, 2012, plus interest and penalty.

11. Petitioner did not provide register tapes during the audit. At the hearing and within the time allowed after the hearing, petitioner produced a sample of z tapes (summaries of the day's activity on the register) for November 19, 24 and 26, 2015, and December 1, 2015 and register tapes for February 15 and 27, 2015.

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, as well as petitioner’s failure to produce such books and records. 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, including any cash register tapes, guest checks or invoices. Having established the unavailability 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 [1957], *cert denied* 355 US 869 [1957]; *Matter of Del’s Mini Deli, Inc. v. Commissioner of Taxation and Finance*, 205 AD2d 989 [1994]; *Matter of Vebol Edibles v. Tax Appeals Tribunal*, 162 AD2d 765 [1990]). 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).

C. 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]). Petitioner failed to produce any documentary evidence to dispute the results of the Division’s observation test or to substantiate petitioner’s argument that the estimate was unreasonable. Indeed, petitioner had no

documentary evidence for the period at issue and the only z tapes and register tapes petitioner provided were from 2015, several years after the period at issue. Petitioner made no showing that tapes from subsequent years could accurately reflect sales from the years at issue. As such, petitioner has failed to meet its burden of proof.

D. Petitioner also contended that Hurricane Sandy negatively impacted subsequent sales. Hurricane Sandy occurred on October 22, 2012, a date years after the audit period and subsequent to the observation test. While sympathetic to the plight of those impacted by the hurricane, an event occurring subsequent to the period at issue has no bearing on the sales for an earlier period and petitioner's argument is without merit.

E. Addressing the issue of penalties, in establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). The Tribunal explained that “[b]y first requiring the imposition of penalties (rather than merely allowing them at the Commissioner’s discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citations omitted]” (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992, *confirmed* 193 AD2d 978 [1993]). Petitioner’s failure to maintain records of the business’s sales supports the imposition of penalties. Petitioner has failed to demonstrate reasonable cause for the failure to pay the taxes due, and the imposition of penalties by the Division was justified (*Matter of Miller v. State Tax Commission*, 94 AD2d 841, 843 [1983]).

F. The petition of Golden Bridge II, Inc., is denied and the Notice of Determination, dated January 30, 2014, is sustained.

DATED: Albany, New York
September 22, 2016

/s/ Barbara J. Russo
ADMINISTRATIVE LAW JUDGE