

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
	:	
of	:	
	:	
WEST GAIETY CORPORATION	:	DECISION
	:	DTA NO. 800826
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, 1977 through	:	
February 29, 1980.	:	

Petitioner, West Gaiety Corporation, c/o Steven M. Coren, 8 West 40th Street, New York, New York 10018, filed an exception to the determination of the Administrative Law Judge issued on April 14, 1988 with respect to its 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, 1977 through February 29, 1980 (File No. 800826). Petitioner appeared by Steven M. Coren, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Neither party filed a brief on exception nor was oral argument requested.

ISSUES

I. Whether petitioner maintained adequate books and records from which the Division could determine the exact amount of tax due for the audit period.

II. Whether, if adequate books and records were not maintained, petitioner established either that the audit method was flawed or that the amount of tax assessed was erroneous.

FINDINGS OF FACT

We find the facts as stated in the Administrative Law Judge's determination and such facts are incorporated herein by this reference and are summarized as follows. We also find additional facts as indicated below.

Petitioner, West Gaiety Corporation ("West Gaiety"), operated a restaurant and delicatessen where it served prepared foods, alcoholic and nonalcoholic beverages and carry-out foods, such as cold cuts and fruits. The restaurant was managed by West Gaiety's president, Lewis Feldman. Since Mr. Feldman was often unable to be present at the restaurant, he hired an accountant to establish a record keeping system, to maintain books and records and to prepare tax returns. The restaurant's employees prepared numbered guest checks for all restaurant sales. A cashier recorded the amounts shown on the guest checks on a cash register which produced a tape. The register had a separate key for sales tax. Guest checks were not prepared for over-the-counter sales of carry-out items, such as cold cuts and fruits. These sales were rung up directly on the register. At the end of each day, totals were taken from the cash register tape, which separately recorded food sales, liquor sales and sales tax. These totals plus cash payments made from the day's cash receipts were recorded in a daily book. A reconciliation was made between cash in the register and the totals recorded on the register tape. Cash receipts were deposited into one bank account and sales taxes were deposited into another. On a monthly or quarterly basis, the accountant, or one of his employees, would summarize the daily sheets, reconcile these summaries with bank statements and record the summaries in a cash receipts book. The guest checks were retained for several months and then discarded. The cash register tapes were maintained, but for how long and in what condition are not known.

An audit of West Gaiety was begun in April 1980, when a letter was sent arranging an appointment between Mr. Feldman and a tax auditor. During the following four months, there was a series of meetings and conversations between the auditor and either Mr. Feldman or West Gaiety's accountant. The auditor requested, and was provided with, sample menus, selling prices of alcoholic beverages, Federal and State income tax returns, a cash receipts journal, a check disbursements journal, purchase invoices for March, April and May 1980, and monthly bank statements. The auditor requested guest checks for the period December 1, 1978 through February 29, 1980. He was told that guest checks were kept for only three to six months; therefore, they were not available for the entire period requested.

From an analysis of the records made available to him, the auditor concluded that petitioner's sales and purchases, as shown in its records, were greater than reported on its Federal and State income tax returns and its sales tax returns. Because of this and because guest checks were not available for the audit period, the auditor determined the need for a test period audit. The auditor conducted three different analyses.

(a) The auditor examined petitioner's claimed nontaxable sales for the month of February 1980. These consisted of sales to exempt organizations and over-the-counter sales of cold cuts and other food items petitioner considered to be exempt from sales tax. Guest checks were not prepared for such items. Petitioner determined its own taxable and nontaxable sales by reference to its register tapes. If sales tax was recorded, the item was deemed to be taxable. If sales tax was not recorded, the item was deemed to be nontaxable. Petitioner had some exempt organization certificates on file, but sales to such organizations were not separately stated. Since petitioner's records were not sufficiently detailed to allow an independent determination of

the taxable status of each sale, the auditor disallowed 75 percent of petitioner's claimed nontaxable sales for the test period.

(b) The auditor examined petitioner's recurring expense purchases such as straws and napkins for the period November 1, 1978 through February 28, 1979 and determined that sales taxes had not been paid on these items.

(c) A markup test was conducted for April and May 1980. Using petitioner's purchase invoices, selling prices provided by petitioner, and his own auditing experience, the auditor estimated petitioner's taxable sales for the audit period and determined that petitioner had underreported sales.

The auditor asked that Mr. Feldman execute a Consent Extending the Period of Limitation for Assessment of Sales and Use Taxes. Because a consent was not received, on September 19, 1980, the Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period June 1, 1977 through November 30, 1977, assessing tax of \$44,230.00 plus interest. The tax assessed was calculated on the basis of the auditor's examination of petitioner's records as described above, but the notice was issued solely for the purpose of assessing a tax within the three-year period required by the statute of limitations found at Tax Law section 1147(b). Petitioner's accountant was so informed and was told that he would have an opportunity to contest the assessment before it became final. Nonetheless, petitioner formally protested the tax assessment by letter dated October 8, 1980.

On or about November 25, 1980, the auditor sent Mr. Feldman a Statement of Proposed Audit Adjustment, asserting sales and use taxes due for the period June 1, 1977 through February 28, 1980 in the amount of 47,174.56 plus penalty and interest. Petitioner disagreed

with the audit results and engaged the services of a second accountant to represent West Gaiety in its contacts with the Division. Several meetings and discussions were held, with Mr. Feldman, the new accountant, the auditor and the auditor's supervisor participating. At these meetings, petitioner presented its case for recomputation of the tax assessment. Primarily, petitioner argued that insufficient allowances had been made for nontaxable sales and sales to exempt organizations, food spoilage and shrinkage from cooking, food given to customers without charge (such as pickles placed on each table and refills of coffee), customer and employee theft, employee meals, discounts given to theatrical groups, employee discounts and sales of liquor by the bottle. As a result of these discussions and of documents produced by petitioner, the auditor made several adjustments to his previous calculations.

(a) Corrections were made to the auditor's categorization of food, beer and liquor purchases.

(b) The auditor recalculated petitioner's average beer and liquor markups and arrived at a markup of 210 percent for beer and 496.7 percent for liquor. The prices used to calculate the markups were estimates based on menu prices and prices provided by petitioner.

(c) The markup on food was reduced to 175 percent. This figure was intended to give some allowance for many of the unquantifiable claims made by petitioner, such as price discounts to certain customers.

(d) Food purchases were reduced by \$45,252.00 as an allowance for employee meals.

(e) An allowance of one-half percent was applied to purchases to account for food spoilage and theft.

(f) It was agreed that purchases of beer and liquor should be reduced by 10 percent as an allowance for discounted sales to employees.

(g) The disallowance of claimed nontaxable sales was reduced to 25 percent.

(h) It was established that petitioner paid all sales taxes on recurring expense purchases and fixed asset purchases; therefore, no tax was assessed on this basis.

Using West Gaiety's purchase records and the markups and allowances described above, the auditor calculated total taxable sales for the audit period of \$1,875,761.00. This figure was reduced by reported taxable sales and allowed nontaxable sales (75 percent of the amount reported on petitioner's returns), and increased by sales of alcoholic beverages purchased by employees at cost. This resulted in unreported taxable sales of \$199,915.00. The latter figure was divided by reported taxable sales of \$1,625,578.00 to calculate an error rate of .123. Petitioner's reported taxable sales of \$1,494,478.00 for the quarters within the period of limitation on assessment,¹ were increased by the error rate, resulting in adjusted taxable sales for the audit period of \$1,678,300.00. A tax rate of 8 percent was applied to taxable sales per quarterly period to determine sales tax due for the period June 1, 1977 through November 30, 1977 of \$2,304.04 and for the period March 1, 1978 through February 29, 1980 of \$11,623.37.

On June 10, 1981, petitioner, by its president, executed a consent extending the period of limitation for assessment of sales and use taxes for the period June 1, 1977 through February 29, 1980 to December 20, 1981. On June 17, 1981, petitioner, by its president, executed a Consent to Fixing of Tax Not Previously Determined and Assessed for the period June 1, 1977 through

¹ the taxable period December 1, 1977 through February 28, 1978 was not included in the assessment because it was barred by the three-year statute of limitations found at Tax Law § 1147(b).

February 29, 1980 in the amount of \$13,927.41. On or about September 8, 1981, the Division issued a Notice of Assessment Review reducing the tax assessed for the period June 1, 1977 through November 30, 1977 to \$2,304.04 plus interest. On September 25, 1981, the Division issued a Notice and Demand for Payment of Sales and Use Taxes Due for the period March 1, 1978 through February 29, 1980, assessing tax due of \$11,623.37 plus interest. On August 5, 1982, West Gaiety filed an Application for Credit or Refund of State and Local Sales or Use Tax, claiming a refund of \$17,165.89 for the periods June 1, 1977 through November 30, 1977 and December 1, 1977 through February 28, 1980. By letter dated October 24, 1985, the Division denied West Gaiety's application for a refund.

The Division's accounts receivable system shows that West Gaiety fully satisfied all liability resulting from the notice and demand issued on September 25, 1981. However, a balance of \$1,840.54 remains due and owing on the liability resulting from the notice of determination issued on September 19, 1980 and revised on September 8, 1981.

We find as an additional fact that petitioner orally agreed to the markup percentages ultimately utilized in calculating the tax assessed.

OPINION

The Administrative Law Judge determined that the petitioner had timely protested the Notice of Determination issued on September 19, 1980 and that the consent fixing the tax with respect to this assessments was null and void because it had been filed more than 90 days after the assessment was issued. Accordingly, the Administrative Law Judge concluded that the petitioner was entitled to a hearing to challenge this assessment.

With respect to the period March 1, 1978 through February 29, 1980, the Administrative Law Judge determined that petitioner had fully paid the amount stated on the Notice and Demand issued on September 25, 1981 and therefore, was entitled to file a claim for a refund.

Also, the Administrative Law Judge found that petitioner's primary sales records did not provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected on that sale. As a result, the Administrative Law Judge held that petitioner's records were inadequate and that the Division of Taxation did not need to obtain petitioner's consent for a test period and markup audit.

On exception, petitioner argues that it maintained full, complete and comprehensive records for a period of at least three years such that sufficient source records were available from which the exact amount of tax due could be determined. As a result, petitioner asserts that the estimation procedures adopted by the Division were arbitrary and capricious since resort to external indices, such as a "test period", is only proper when there is an insufficiency of record keeping which makes it virtually impossible to verify taxable sales and conduct a complete audit. In the alternative, petitioner argues that the markup method used was arbitrary and capricious because its basis was without substantiation and certain allowances were either not granted or not granted the proper extent.

The Division asserts that petitioner failed to maintain adequate books and records therefore it was warranted in resorting to a test period audit and markup of purchases to determine petitioner's liability. Specifically, the Division contends that the auditor, despite his requests, was not provided with sufficient and verifiable books and records supported by adequate source documentation.

We affirm the determination of the Administrative Law Judge.

Petitioner's contentions are without merit. The record indicates that the records of the restaurant were incomplete and inaccurate. Thus, the use of external indices, specifically a test period audit and markup of purchases was appropriate.

Tax Law section 1105(d)(i) imposes a tax on the sale of food and drink by petitioner. Tax Law section 1132 requires petitioner to collect this tax and it also places the burden of proof on him to show that any particular item is not taxable. Further, petitioner is required to maintain records of his sales for audit purposes pursuant to section 1135 of the Tax Law. When conducting an audit, Tax Law section 1138 requires the Division to determine tax due from the information that is available, however, if necessary the Division may estimate taxes on the basis of external indices.

Additionally, the Division is required to make an actual request for the taxpayer's books and records (Matter of Christ Cella, Inc. v. State Tax Commn., 102 AD2d 352) for the entire period of the assessment (Matter of Adamides v. Chu, 134 AD2d 776, lv to appeal denied 71 NY2d 806) and the Division must make a thorough examination of such records (Matter of King Crab Restaurant, Inc. v. Chu, 134 AD2d 51) before proceeding to external indices to determine the taxpayer's sales tax liability. Further, if records are available from which the exact amount of tax can be determined then resort by the Division to estimation procedures would be arbitrary and capricious and lack a rational basis (Matter of Grant Co. v. Joseph, 2 NY2d 196, cert denied 355 U.S. 869; Matter of Korba v. State Tax Commn., 84 AD2d 655). However, when the records are not sufficient, resort to external indices is permissible (Matter of Murray's Wines & Liqs. v. State Tax Commn., 78 AD2d 947; Matter of Sakron v. State Tax Commn., 73 AD2d

989) and the Division is not required to compute the amount due with exactness (Matter of Meyer v. State Tax Commn., 61 AD2d 223, mot for lv to appeal denied 44 NY2d 645).

On exception, petitioner contends that only a weak and casual request for records, at most, was made.

We find that more than a casual and weak request for petitioner's records was made. It is true that no copy of a written request is available, however, this is not fatal to the sufficiency of the request. The credibility of the auditor's testimony that both oral and written requests were made combined with the facts that his testimony was uncontradicted and the audit report refers to a request having been made supports the conclusion that the request for records here was sufficient.

Petitioner also excepts to the finding of fact that guest checks were only retained for three to six months. Petitioner offers no testimony, or other evidence, contrary to the auditor's statement that he was only provided with guest checks for three to six months, other than the statement that guest checks were kept "for a long period of time". We sustain the finding that guest checks were retained for a period of only three to six months. It should be noted that while petitioner complains of problems with the storage of numerous records, including guest checks, petitioner failed to avail itself of 20 NYCRR 533.2(a)(4) which provides:

"Guest checks must be retained for at least three years unless an application is filed with the District Office Audit Bureau and permission is granted by the bureau to destroy the guest checks before the expiration of the three-year statute of limitation."

The guest checks lack of completeness is emphasized further by the fact that guest checks were not prepared for sales deemed to be nontaxable by petitioner's employees. 20 NYCRR 533.2(b)(2) requires that sales records "either must provide sufficient detail to independently

determine the taxable status of each sale and the amount of tax due and collected thereon or may be substantiated by analysis of supporting records". Since there was no way for an auditor to determine whether each sale was rung up on the register or whether petitioner's employees accurately determined the taxable status of each sale, the available guest checks, register tapes and daily book were rendered useless for the audit (see, Matter of Licata v. Chu, 64 MY2d 873). As a result, we conclude that petitioner's primary sales records did not provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected on that sale. Therefore, the Division's resort to a markup of purchases to determine petitioner's liability was appropriate.

Petitioner alleges that the markup percentage used in the audit was arbitrary and capricious because it was based on the unexplained experience of the auditor. Our review of the record indicates that the food markup percentage was based solely on the auditor's experience and that this experience is unacceptably vague. The auditor testified that the food markup was based entirely on experience and other audits, without any specific description of this experience. Based on Grecian Square, Inc. v. State Tax Commn. (119 AD2d 948), such unqualified experience does not provide a sufficient basis to sustain the markup percentage used (see also, Matter of Willy Savino d/b/a Willy's Service Station, Tax Appeals Tribunal, September 22, 1988). Without more, this portion of the audit would be unsupportable. However, the record also indicates, consistent with the auditor's testimony, that the individual who represented petitioner during the audit acknowledged that he and the petitioner orally agreed to the markup. We conclude that petitioner's agreement to the markup confirms the reasonableness of the percentage, notwithstanding the uncertainty as to its source.

Petitioner's contention that a sufficient margin was not allowed for employee meals, theft, spoilage, waste and other items is also denied. On this issue the burden of proof was on the petitioner and it failed to present sufficient proof to establish the extent of such losses (see, Matter of Licata v. Chu, supra, at 874; Matter of Petroleum Sales & Service v. Bouchard, 64 NY2d 671).

Next, we agree with the conclusion of the Administrative Law Judge that petitioner's explanation for the discrepancy between its sales records and income tax returns is irrelevant. The resort to estimate procedures in this case was justified by the inadequate sales records, not by their inconsistency with the income tax returns.

Lastly, we address petitioner's contention that his plight is comparable to that of the taxpayer in Matter of King Crab Restaurant, Inc. v. Chu (supra). In King Crab, the taxpayer presented the auditor with guest checks, bank statements, a general ledger, a cash disbursements journal and purchase invoices for the entire audit period, except for the first seven months. Even though the taxpayer in King Crab did not have cash register tapes, it was possible to determine the necessary information from the other sources made available (see, Matter of Christ Cella, Inc. v. State Tax Commn., supra). In the instant case, petitioner failed to provide useful cash register tapes, and guest checks were only retained for a period of three to six months. As a result, it was not possible to ascertain the necessary information from petitioner's records as it was in King Crab where guest checks were retained for almost the entire period.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of West Gaiety Corporation is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed;

3. The petition of West Gaiety Corporation is in all respects denied and the denial of petitioner's claim for a refund is sustained.

Dated: Albany, New York
December 08, 1988

/s/ John P. Dugan
President

/s/ Francis R. Koenig
Commissioner