

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions :

of :

WEST MARKET DINER, INC., :
AND MARVIN ZELIN AND ASHER ZELIN :
AS OFFICERS OF WEST MARKET DINER, INC. :

DECISION

for Revision of Determinations or for Refunds :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period March 1, 1979 :
through November 30, 1982. :

In the Matter of the Petitions :

of :

MARKET DINERS, INC., :
AND MARVIN ZELIN, MURRAY ZELIN AND :
IRVING ZELIN, AS OFFICERS OF :
MARKET DINERS, INC. :

for Revision of Determinations or for Refunds :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period December 1, 1978 :
through November 30, 1982. :

Petitioner West Market Diner, Inc., 256 West Street, New York, New York 10013, filed an exception to the determination of the Administrative Law Judge issued on May 12, 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 March 1, 1979 through November 30, 1982 (File No. 801001).

Petitioners Marvin Zelin, 356 Derby Avenue, Woodmere, New York 11598, and Asher Zelin, 256 West Street, New York, New York 10013, as officers of West Market Diner, Inc. each filed an exception to the determination of the Administrative Law Judge issued on May 12, 1988 with respect to their petitions for revision of a determination or for refund of sales and use taxes

under Articles 28 and 29 of the Tax Law for the period March 1, 1979 through November 30, 1982 (File Nos. 800980 and 800978).

Petitioner Market Diners, Inc., 411 Ninth Avenue, New York, New York 10001, filed an exception to the determination of the Administrative Law Judge issued on May 12, 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 December 1, 1978 through November 30, 1982 (File No. 801000).

Petitioners Marvin Zelin, 356 Derby Avenue, Woodmere, New York 11598, Murray Zelin, 17A Bedfordshire Drive, Cranbury, New Jersey 08512 and Irving Zelin, 219 Brightwater Court, Brooklyn, New York 11235, as officers of Market Diners, Inc., each filed an exception to the determination of the Administrative Law Judge issued on May 12, 1988 with respect to their petitions for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1978 through November 30, 1982 (File Nos. 800979, 800976 and 800977).

Petitioners appeared by Goldfinger and Lassar, Esqs. (Stephen D. Lassar, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Michael Gitter, Esq., of counsel).

Briefs were submitted by both parties and oral argument was held at the request of the petitioners on November 9, 1988.

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

ISSUES

I. Whether assessments of sales and use taxes issued against the petitioner corporations, following a Division field audit, were proper as to methodology and result and should be sustained.

II. Whether, if so, the petitioner corporations have nonetheless established any bases warranting abatement of penalties imposed for failure to have remitted sales and use taxes due.

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 except that we modify findings of fact "10" and "12" as stated below.

On December 20, 1983, following a field audit, the Division issued to the entities and individuals¹ listed below the following notices of determination and demands for payment of sales and use taxes due for the periods and in the amounts indicated, together with penalty and interest. It is undisputed that each of these notices of determination were timely issued pursuant to a series of validated consents extending the period of limitations on assessment, the latest of which allowed assessment to occur for the periods in question at any time on or before December 20, 1983. The notices are as follows:

<u>ISSUED TO</u>	<u>PERIOD</u>	<u>TAX AMOUNT</u> ²
West Market Diner, Inc.	3/1/79-8/31/82	\$61,878.90
West Market Diner, Inc.	9/1/82-11/30/82	4,423.74
Asher Zelin	3/1/79-8/31/82	60,784.36
Asher Zelin	9/1/82-11/30/82	4,388.55
Marvin Zelin	3/1/79-8/31/82	60,784.36
Marvin Zelin	9/1/82-11/30/82	4,388.55
Market Diners, Inc.	12/1/78-5/31/82	65,756.89
Market Diners, Inc	6/1/82-11/30/82	9,260.12
Marvin Zelin	12/1/78-5/31/82	65,126.47
Marvin Zelin	6/1/82-11/30/82	9,213.01
Murray Zelin	12/1/78-5/31/82	65,126.47
Murray Zelin	6/1/82-11/30/82	9,213.01
Irving Zelin	12/1/78-5/31/82	65,126.47
Irving Zelin	6/1/82-11/30/82	9,213.01

The dollar amounts shown on the above notices of determination issued against the corporate entities may be more specifically broken down as follows:

¹The notices issued to the four named individuals are so issued upon the premise that such individuals were officers responsible to collect sales tax on behalf of the corporate entities.

²The tax amounts shown are exclusive of penalty (Tax Law former § 1145[a][1]) and interest.

(a)	<u>West Market Diner</u>	
	Use tax on expense purchases	\$ 527.73
	Use tax on fixed assets	602.00
	Sales tax on overcollections	3,376.99
	Parking tax	944.70
	Sales tax on food & beverage sales	<u>60,851.22</u>
	Total	<u>\$66,302.64</u>
(b)	<u>Market Diners, Inc.</u>	
	Use tax on expense purchases	\$ 450.48
	Use tax on fixed assets	227.05
	Sales tax on overcollections	1,852.47
	Sales tax on food & beverage sales	<u>72,487.01</u>
	Total	<u>\$75,017.01</u>

The dollar differences between the amounts assessed against the corporate petitioners versus the amounts assessed against the individual petitioners result from the fact that use tax on expense purchases and on fixed assets was not assessed against the individual petitioners.

It was conceded at hearing that Asher Zelin and Marvin Zelin were persons required to collect sales tax on behalf of West Market Diner, Inc. and that Marvin Zelin, Murray Zelin and Irving Zelin likewise were responsible for the collection of sales tax on behalf of Market Diners, Inc. Accordingly, the only remaining issue herein is the propriety of the sales and use tax assessments (with attendant penalties) issued after the field audit conducted with respect to the corporate petitioners. During the respective periods in issue petitioners West Market Diner, Inc. ("West") and Market Diners, Inc. ("Market") each operated railroad car-style diners. The diners were open 7 days per week and 24 hours per day. Although not entirely clear from the record, it appears the petitioner corporations filed their sales and use tax returns by computing taxable sales based upon an estimate of taxable to nontaxable sales in accordance with a taxable ratio determined upon a prior audit (i.e., application of estimated taxable percentage to gross sales).

In or about March of 1982, the Division commenced a sales and use tax field audit of the operations of the corporate petitioners, West and Market. The auditor requested by letter that these petitioners produce records of their business operations, specifically those records related to the calculation of sales and use tax liabilities. Petitioners provided cash receipts journals, check

disbursements journals and general ledgers for the audit period, as well as cancelled checks and monthly bank statements. However, guest checks and cash register tapes were not available per request at the time of audit, and it is undisputed that neither guest checks nor cash register tapes were retained by petitioners for the periods under audit. Further, although guest checks are used at both diners, they are not always used for each sale, nor are those guest checks used accounted for thereafter in sequential order.

Petitioners noted that at the end of each business day, each diner's summary cash register tapes were transcribed into a daily book. However, based upon the unavailability of either sequentially-numbered guest checks or cash register tapes, and notwithstanding the aforementioned transcription into and maintenance of a daily book of summary receipts, the auditor determined petitioners' records to be inadequate for purposes of conducting a detailed audit and determined it was appropriate to utilize indirect audit methodologies in an attempt to verify the correctness of petitioners' sales and use tax returns as filed.

As noted above, the auditor found certain (comparatively small) amounts of tax due on a number of items, including use tax on expense purchases and fixed assets, as well as parking tax and sales tax on overcollections. At hearing, these amounts were conceded by petitioners as due and owing and are not challenged or at issue in this proceeding. Accordingly, the major portion of the assessments herein, representing sales tax determined to be due on food and beverage sales, together with the related issue of the appropriateness of assessing a penalty, are the only items remaining for determination in this proceeding.

The Division first performed an "observation test" of the operation of West and Market. Two separate eight-hour days of observation were used for each diner, specifically the dates of September 10 and 14, 1982 for West and January 19 and 22, 1982 for Market. Certain of the sales observed at each diner were noted as nontaxable (e.g., sales of cold cuts by the pound and of bakery goods for off-premises consumption). The results of the observation tests were thereafter projected forward based on the number of days and hours the diners were open (taking into account in such projection the nontaxable percentage of sales observed at each diner and adjusting

the results for inflation increases each year). These projections were compared to each diner's sales and use tax returns with the result being a determination that each diner owed additional tax.

The results of the observation tests were reviewed with petitioners and their representatives, at which time a number of disagreed items were discussed. In the course of the review, it was agreed between petitioners and the Division that a re-audit would be undertaken utilizing a "markup" audit methodology, specifically involving a test period of purchase invoices for September 1982, together with selling prices from a September 1982 menu. Accordingly, utilizing West's September 1982 purchase invoices and the prices in effect per a September 1982 menu, the Division performed a "main item" markup audit.

Finding of fact "10" is modified to read as follows:

In brief, this main item markup audit methodology involves finding the "main item" on a given type of sale made by petitioner (e.g., steak on a steak platter) and finding a comparable purchase of such a main item per the purchase invoices.

The audit work papers clearly indicate that the markup methodology took into account the various ways in which such main item purchases were sold by petitioner. Thus, for example, purchases of bologna, salami, boiled ham and fresh ham were used in the main item mark up at sandwich prices. Corned beef, pastrami and knockwurst were main item priced both as sandwiches and platters with country sausages main item priced as both an entree and with eggs.

A per portion (e.g., per platter) amount of such item is determined and, after allowance for trimming and shrinkage, the number of portions available from the amount of the main item purchased (per the purchase invoices) is calculated. The total number of portions thus available is multiplied by the selling price of the platter, sandwich or entree (per the menu) to arrive at a sales receipts figure for such main item purchased. This procedure is followed for each main item purchased such that, after all comparisons are made in this manner, a gross sales figure is arrived at for the test period. Thereafter total purchase costs (per purchase invoices) are subtracted from gross sales (for the test period) to arrive at gross profit. In turn, gross profit is divided by cost of goods purchased to yield a markup percentage. It is noted that no specific cost or markup is attached to items on a given platter other than the main item, with the cost of such other items being deemed included in the selling price of the total platter.

The Division followed this methodology in general and applied the markup derived for the test period to petitioner West's purchases for the entire audit period to arrive at gross sales.

Thereafter, an allowance reducing gross sales was made to reflect employee meals, specifically at the rate of two meals per day per employee (with the number of employees calculated per West's payroll information) at \$4.00 per meal. The employee meal allowance was reduced for each year from 1981 back through 1979 at the rate of 9 percent per year, stated by the auditor to be a factor calculated to give cognizance to inflation. Gross sales were also reduced by nontaxable sales based on the percentage of nontaxable sales determined per the prior observation test (26.274 percent nontaxable), and audited taxable sales resulted. Comparison was then made between audited taxable sales and reported taxable sales and a differential in tax equal to \$60,851.22 was determined.

Finding of fact "12" is modified to read as follows:

The main item markup described above resulted in a markup percentage for West of 217.558 percent over cost. In computing the number of platters and sandwiches and entrees to be derived out of the amount of main items purchased, the auditor allowed for shrinkage, trimming and waste by increasing the portion size rather than by allowing a shrinkage percentage per se.

In addition to calculating tax due, the auditor recommended that penalty pursuant to Tax Law former section 1145(a) be added in that, in her opinion, there was no reasonable cause shown by the taxpayer for the abatement of penalty. The auditor's choice of increasing portion size as a means of allowing for shrinkage and trimming, rather than estimating shrinkage and trimming and then figuring portion size, was to make one mathematical calculation instead of two. The actual estimate of portion size (pre-shrinkage) was based on the auditor's experience and the experience of her supervisor, and also on the basis of reference to Division standard shrinkage charts. Assumptions inherent in the auditor's calculations included the assumption that all cheese purchased was sold in sandwiches (the auditor noted there was no basis to differentiate between cheese types as to main items), and the assumption that one-half of the eggs purchased were used other than as main items (e.g., in cooking, baking, etc.).

With respect to petitioner Market, the Division applied the same markup as was determined on the audit of West against Market's purchases for the audit period. Similarly, the same employee meal allowance, including the 9 percent factor reducing said allowance for inflation,

was used. In addition, an allowance was made for nontaxable sales based on the results of the prior observation test of Market (specifically 22.01 percent of sales).

The auditor applied the markup determined on West to Market on the bases that the diners were both part of a series of family-owned diners, had the same style and method of operation, were open the same number of days and hours, and were lacking the same records deemed requisite for the conduct of a complete, detailed audit. In addition, use of the same markup was deemed appropriate and necessary because the Division although obtaining menus from Market was unable, despite requests, to secure a menu from Market dated for September 1982. The auditor also alleged that use of West's markup upon Market was, at least tacitly, agreed to by petitioner Market's representatives. Similarly, penalty pursuant to Tax Law section 1145(a)(1) was imposed based upon the auditor's belief that reasonable cause for abatement thereof had not been shown.

Included in evidence were comparative figures as to each of the diners' sales, cost of goods sold and resultant gross profit percentages as taken from their United States Corporation Income Tax Returns, as well as menus from each of the diners. Review of these various documents reveals differences between the diners both as to their respective menu prices as well as their profit percentages.

OPINION

The Administrative Law Judge upheld the main-item markup audit methodology performed on the operation of West Market Diner, Inc. and the application of the results of that audit to petitioner Market Diners, Inc., with modifications to some elements of the audit. The modifications included the elimination of the reduction of the estimate of the employee food allowance by 9 percent to reflect inflation and, further, a modification that the markup at Market Diners, Inc. was to be adjusted 7.5 percent less than the markup of West. Further, the Administrative Law Judge found no credible evidence to waive penalty.

On exception petitioners argue that the audit was flawed in that estimates as to portion size, shrinkage, and trimming were erroneous, no allocation was made of petitioners' meals on the basis

of sandwiches versus platters, the Department's estimates should be replaced by estimates made by petitioners and penalties should be abated because of petitioners' prior audit history.

We sustain the determination of the Administrative Law Judge.

Section 1135 of the Tax Law, in effect during the period at issue, requires every person required to collect sales tax to keep records of every sale and of the tax payable thereon. "Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum" (Tax Law § 1135). Here, while petitioners did maintain certain books and records which were made available to the Division, these records were insufficient for verification of taxable sales since a record of each individual sale, as required pursuant to Tax Law section 1135 and companion regulations (see, 20 NYCRR 533.2), was not retained by petitioners. More specifically, no guest checks or cash register tapes were available for the period in question. Where insufficient records are kept and it is impossible to conduct a complete audit, ". . . the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138[a]; Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44).

"When records are not provided or are incomplete and insufficient, it is [the Commission's] duty to select a method reasonably calculated to reflect the taxes due . . . The burden then rests upon the taxpayer to demonstrate . . . that the method of audit or the amount of the tax assessed was erroneous" (Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858 [citations omitted]).

Here petitioners do not challenge the Division's right to resort to an estimated audit method and, in fact, agreed to a reaudit utilizing a "markup" methodology after first rejecting the results of an observation test audit. Petitioners challenge is to the Division's estimates as to portion size, shrinkage and trimming and that the Division did not take into account the various ways in which the petitioners sold their main item purchases, in particular that the Division allowed no allocation on the basis of sandwiches versus platters. We find these assertions without merit. The auditor included sandwiches, platters and entrees as part of the main item mark up audit. Further, portion

size, shrinkage and trimming were included in the auditor's calculations. It is clear that indirect audit methodologies may not always result in an exact determination of liability. It is equally clear that where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to such indirect audit techniques, exactness is not required of the Division in arriving at its determination, and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Brothers, Inc. v. Chu, 139 AD2d 813).

The Administrative Law Judge noted that petitioners' estimates would not appear any more reasonable than those utilized by the Division. We agree and note that audit exactness is not required when it is petitioners' own failure to maintain proper records which prevents the Division from determining the exact sales tax liability (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, affd 44 NY2d 684), and, further, said failure to have maintained necessary records must weigh against petitioners (see, Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943).

As to the petitioners' request for abatement of penalties, we agree with the Administrative Law Judge in that the penalty as imposed is appropriate and is, therefore, sustained. In order for the penalties to be abated the burden is on petitioners to establish reasonable cause as well as the absence of willful neglect (see, Matter of Baird v. State Tax Commn., 102 AD2d 958; Matter of Miller v. State Tax Commn., 94 AD2d 841). We find that petitioners did not meet their burden. Petitioners in computing their liability and filing their returns based on estimates ran the risk that upon audit a substantial underpayment would be computed. This is exactly what occurred and penalties, therefore, must be sustained.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions of petitioners West Market Diner, Inc., and Marvin Zelin and Asher Zelin as Officers of West Market Diner, Inc. and Market Diners, Inc., and Marvin Zelin, Murray Zelin and Irving Zelin as Officers of Market Diners, Inc. are in all respects denied;
2. The determination of the Administrative Law Judge is affirmed; and

3. The petitions of West Market Diner, Inc., and Marvin Zelin and Asher Zelin as Officers of West Market Diner, Inc. and Market Diners, Inc., and Marvin Zelin, Murray Zelin and Irving Zelin as Officers of Market Diners, Inc. are granted to the extent indicated in conclusions of law "E" and "G" of the Administrative Law Judge's determination; the notices of determination and demand for payment of sales and use taxes due issued on December 20, 1983 are modified accordingly; and except as so granted the petitions in all other respects are denied.

DATED: Troy, New York
May 4, 1989

/s/ John P. Dugan
John P. Dugan
President

/s/ Francis R. Koenig
Francis R. Koenig
Commissioner