

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
1866 RESTAURANT CORPORATION : DECISION
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, 1980 through :
February 29, 1984 :

Petitioner, 1866 Restaurant Corporation, 1866 Ralph Avenue, Brooklyn, New York 11234 filed an exception to the determination of the Administrative Law Judge issued on September 1, 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, 1980 through February 29, 1984 (File No. 801312). Petitioner appeared by Charles Kirkiles, P.A. The Division of Taxation appeared by William F. Collins, Esq. (Kevin A. Cahill, Esq., of counsel).

Neither party submitted a brief on exception. Petitioner's request for oral argument was denied.

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

ISSUE

Whether penalties assessed against petitioner should be waived.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and these facts are stated below.

On April 12, 1984, the Division of Taxation issued to 1866 Restaurant Corporation ("petitioner") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due in the amount of \$381,404.31, plus penalty and interest, for a total amount due of \$466,590.37 for the period December 1, 1980 through February 29, 1984.

On January 6, 1984, petitioner purchased from Corina Realty Corporation (the "seller") a diner business known as "The Arch" which was located at 1866 Ralph Avenue, Brooklyn, New York.

On January 13, 1984, the Sales Tax Bureau of the Department of Taxation and Finance received from petitioner a Notification of Sale, Transfer or Assignment in Bulk which advised that, on January 6, 1984, it had purchased the aforesaid diner business from the seller. The total sales price of the business was omitted, but the sales price of the furniture, fixtures, etc. was listed as \$55,000.00. Bulk sales tax in the amount of \$4,537.50 ($\$55,000.00 \times 8\frac{1}{4}\%$) was paid on January 25, 1984.

On January 18, 1984, the Division issued to petitioner a Notice of Claim to Purchaser which notified it of a possible claim for New York State and local sales and use taxes from the seller. The said Notice of Claim to Purchaser further stated that, in spite of any provisions contained in the sales contract, no distribution of funds or property, to the extent of the amount of the State's claim, could be made before the following conditions had been met:

- (a) The State Tax Commission had determined the seller's liability, if any.
- (b) Payment of such liability had been made to the State.
- (c) The Central Sales Tax Section of the Division had authorized the release of the funds or property.

On January 27, 1984, the Division notified the seller that it would be contacted by the district office to make the necessary arrangements for an examination of its books and records.

On March 2, 1984, the seller executed a consent extending the period of limitation for assessment of sales and use taxes whereby it agreed that such taxes for the period December 1, 1980 through February 28, 1981 could be assessed at any time on or before June 20, 1984.

An audit of the seller's books and records was commenced in February 1984. Sales tax returns and related worksheets, Federal corporation income tax returns and State franchise tax reports with related worksheets, depreciation schedules, a cash receipts journal, a check

disbursements journal, purchase invoices, cancelled checks, monthly bank statements and journal entry sheets were provided to the auditor. Guest checks, register tapes and day books were not made available. The seller's accountant, at the time of the audit, informed the auditor that he had requested and had received permission from the Department of Taxation and Finance to destroy the guest checks and register tapes prior to the commencement of the audit. No proof of such request or permission to destroy such records was produced herein.

The auditor visited the business premises. He observed that it was a 24 hour diner with a seating capacity of approximately 235 and that it employed 35 to 40 persons.

The auditor reconciled gross sales per books to gross sales per returns filed which were found to be substantially in agreement. The seller's income and franchise tax returns were also found to be in agreement with sales per books and sales tax returns. The auditor then examined the statement of closing of petitioner's purchase of the diner which revealed that, pursuant to such document, petitioner had obligated itself to annual rental payments of approximately \$84,000.00 (\$7,000.00 per month plus a cost of living increase equal to $\frac{1}{2}$ of the fractional increase in the Consumer Price Index for the prior lease year above that in effect for the month of May 1983) and annual promissory note payments of approximately \$245,108.00. Based upon the unavailability of source documents, i.e., guest checks and register tapes, together with the auditor's conclusion that, based upon sales reported by the seller, petitioner would not be able to meet these payments, the auditor determined that an audit using external indices was proper herein.

Initially, the auditor sent letters to the seller's liquor and wine suppliers and to some of its main food suppliers in an attempt to confirm the seller's purchases. The replies received were "in general" and the auditor was, therefore, not able to match such replies completely with purchases set forth in the seller's books. While not all suppliers responded to the auditor's confirmation letters, the responses received generally corresponded to the purchases as set forth in the seller's records. As a result of his inability to perform a complete analysis of purchases, the auditor decided to use an audit method which employed a rent factor derived from Dun & Bradstreet, Inc.

("D & B"). The rent factor (4.93%), which represented the percentage of business receipts expended for rent, was calculated by D & B using a representative sample of the total of all Federal income tax returns filed by "eating and drinking" places for the period July 1976 through June 1977. The July 1976 through June 1977 D & B edition was utilized because it was the most recent edition available in the auditor's office. Additional taxable sales were calculated as follows:

Rent/year	\$ 84,000
D & B rent factor 100 divided by 4.93 =	<u>x 20.28</u>
	\$1,703,520
	Divided by <u>4 quarters</u>
Gross sales per quarter	\$ 425,880
Number of quarters (12/1/80-1/6/84)	<u>x 12.5</u>
Gross/taxable sales	\$5,323,500
Less reported	<u>3,052,279</u>
Additional taxable sales	\$2,271,221

\$2,271,221.00 divided by 12.5 quarters = \$181,698.00 additional taxable sales per quarter

Based upon the rates in effect for the applicable periods, sales tax due on these additional taxable sales was determined to be \$186,013.05.

According to the statement of closing, the selling price of the business was \$2,350,000.00. Bulk sales tax was originally assessed on the entire selling price ($8\frac{1}{4}\%$ x \$2,350,000.00 = \$193,875.00). At the hearing, the Division of Taxation agreed that such tax should have been assessed only on the value of the furniture and fixtures (\$55,000.00) plus the value of the dining car structure (\$130,000.00). The bulk sales tax is, therefore, reduced from \$193,875.00 to \$15,262.50.00 ($8\frac{1}{4}\%$ x \$185,000.00). Since bulk sales tax in the amount of \$4,537.50 was previously remitted, total bulk sales tax of \$10,725.00 remains at issue herein.

Additionally, the auditor examined the seller's recurring expenses for rubbish removal on which tax had not been paid. For the period at issue, expenses of \$15,214.00 were determined to have been incurred and tax due thereon was assessed in the amount of \$1,248.14. The auditor also disallowed certain fixed asset acquisitions totalling \$3,250.00 on which tax due was determined to be \$268.12. At the hearing, petitioner agreed to that portion of the assessment

which related to recurring expenses and fixed asset acquisitions (\$1,248.14 + \$268.12 = \$1,516.26).

Inasmuch as petitioner has agreed to the tax assessed on the recurring expenses and fixed asset acquisitions (\$1,516.26) and the Division of Taxation has agreed to a reduction in bulk sales tax in the amount of \$178,612.50 (\$193,875.00 - \$15,262.50), the total amount of tax remaining at issue herein is reduced to \$201,275.55 which amount represents sales tax assessed on additional taxable sales, which were determined by the auditor by means of the D & B rent factor (\$190,550.55), plus bulk sales tax remaining at issue (\$10,725.00).

A prior audit of the seller's business for the period September 1, 1976 through May 31, 1979 resulted in an assessment in the amount of \$459.00 which represented an overcollection which had not been remitted to the Department of Taxation and Finance.

The auditor did not analyze the cash flow of petitioner to determine whether or not its rental and promissory note obligations could be met. While the sale of the business did not occur until January 6, 1984, petitioner operated the business from May 1983. Although the D & B rent factor was applied to determine the seller's additional taxable sales, it must be noted that the seller paid no rent during the period at issue. For the fiscal years at issue herein, the seller reported sales as follows:

<u>Fiscal Year Ended</u>	<u>Sales Per Federal Returns</u>	<u>% Increase</u>
6/30/81	\$863,151.79	
6/30/82	\$918,566.17	6.42
6/30/83	\$986,391.24	7.38

The D & B edition for the fiscal year July 1982 through June 1983, while not issued until 1986, indicated a rent factor for the aforesaid period of 5.78 percent. It must further be noted that the term of the lease (\$7,000.00 per month plus a cost of living increase based on a fraction of the Consumer Price Index) was for 35 years or until April 30, 2018. The lease was "front-loaded", i.e., it was designed to allow the lessor to realize a large return early in the period due to the

uncertainty of its receiving a reasonable return in the later years of the lease. On page 4 of the statement of closing is contained the following language:

"Premises: The land only at 1866 Ralph Avenue, Brooklyn, New York. (Please note that the diner is considered personal property and not part of the real estate.)"

OPINION

The Administrative Law Judge concluded that the methodology utilized by the Division of Taxation to estimate the sales tax due from additional taxable sales made by the seller was unreasonable and cancelled this portion of the assessment (\$190,550.55). The other portion of the assessment remaining at issue in the hearing, \$10,725.00 in tax, was sustained by the Administrative Law Judge. This amount represents tax on the \$130,000.00 consideration for the dining car structure transferred by the seller to petitioner in the bulk sale. The Administrative Law Judge concluded that the dining car was tangible personal property, not real property, and was subject to sales tax. The Administrative Law Judge made no explicit conclusions with respect to the imposition of the penalty, but in sustaining the assessment, except as modified, the penalty was imposed on the remaining tax due.

On exception, petitioner challenges only the Administrative Law Judge's failure to abate the penalty assessed against petitioner. Petitioner argues that the penalty should not be imposed because it complied with and did not willfully violate the Tax Law. Petitioner also argues that since the seller remains liable for the tax at issue, the penalty cannot be assessed against petitioner.

We affirm the determination of the Administrative Law Judge.

With respect to the tax imposed on the transfer of tangible personal property from the seller to petitioner, petitioner was under a duty to pay this tax directly to the Division of Taxation (Tax Law § 1133[b]). The failure to pay this tax was properly subject to penalty (Tax Law § 1145[a][1][i]) which can be waived only if petitioner showed the failure was due to reasonable

cause and not to willful neglect (Tax Law § 1145[a][1][iii]). We find no evidence in the record indicating that the failure was due to reasonable cause.

With respect to the penalty imposed on the seller's expenses and fixed acquisition purchases, we have held that the bulk purchaser who fails to comply with the requirements of section 1141(c) of the Tax Law may be liable for penalty assessed against the seller (Matter of Giovanni Velez, Tax Appeals Tribunal, May 26, 1988). The record contains no evidence that the seller's failure to pay this tax, or petitioner's failure to comply with section 1141(c) of the Tax Law, was due to reasonable cause and was not due to willful neglect. Accordingly, there is no basis under section 1145(a)(1)(iii) to waive penalty on this portion of the assessment.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of 1866 Restaurant Corporation is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of 1866 Restaurant Corporation is granted to the extent indicated in conclusions of law "C", "D" and "E" of the Administrative Law Judge's determination but is in all other respects denied; and
4. The Division of Taxation shall modify the Notice of Determination issued on April 12, 1984 accordingly but the Notice is otherwise sustained.

DATED: Troy, New York
August 31, 1989

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

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