STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition of **VEBOL EDIBLES, INC.** **D/B/A HICKORY HOUSE** 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, 1981 through February 29, 1984.	DECISION DTA No. 801639 & 802544
In the Matter of the Petition of **EDWARD BOLSKI,** **OFFICER OF VEBOL EDIBLES, INC. D/B/A HICKORY HOUSE** 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, 1981 through November 30, 1984.	

Petitioner, Vebol Edibles, Inc. d/b/a Hickory House, 109 East 59th Street, New York, New York 10022, filed an exception to the determination of the Administrative Law Judge issued on January 7, 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, 1981 through February 29, 1984 (File No. 801639).

Petitioner, Edward Bolski, Officer of Vebol Edibles, Inc. d/b/a Hickory House, 108-17 86th Avenue, Richmond Hill, New York 11418 filed exceptions to the determination of the Administrative Law Judge issued on January 7, 1988 with respect to his petitions 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, 1981 through November 30, 1984 (File Nos. 801635 and 802544).

Petitioners appeared by Sylvor, Schneer, Gold & Morelli (Richard L. Gold, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Irwin A. Levy, Esq., of counsel).

Neither party submitted a brief on exception. Oral argument was heard at the request of the petitioners on July 12, 1988.

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

ISSUE

Whether the audit method used to determine additional taxes due from Vebol Edibles, Inc. d/b/a Hickory House was reasonably designed to estimate the 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. These facts are summarized below. We also find a fact, as indicated below, in addition to those found by the Administrative Law Judge.

On September 20, 1984, the Division of Taxation, as a result of a field examination, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to Vebol Edibles, Inc. d/b/a Hickory House (hereinafter 'Vebol'). Said notice, which encompassed the period March 1, 1981 through February 29, 1984, assessed sales taxes due of $78,426.78, plus penalty of $16,645.33 and interest of $20,035.54, for a total amount due of $115,107.65. A Notice of Determination and Demand for Payment of Sales and Use Taxes Due was also issued

on September 20, 1984 to Edward Bolski as an officer of Vebol. The notice issued to Mr. Bolski assessed amounts identical to those assessed against Vebol.

On June 20, 1985, the Division issued a second notice to Edward Bolski as an officer of Vebol for the quarters ended August 31, 1982, May 31, 1983, August 31, 1983, May 31, 1984, August 31, 1984 and November 30, 1984. The notice assessed additional sales taxes due of $16,607.07, plus penalty of $3,589.68 and interest of $3,437.45, for a total amount due of $23,634.20. The $16,607.07 in tax assessed against Mr. Bolski individually represented tax due shown on returns filed by Vebol where the checks issued by Vebol in payment of the tax were returned because of insufficient funds.

At the hearing held on April 30, 1987, petitioner Edward Bolski conceded that he is personally liable for any taxes which may be due from Vebol for the periods in issue. Mr. Bolski also conceded the additional tax, penalty and interest due as assessed in the notice dated June 20, 1985, with the sole exception that he had not been given credit for all payments which were made. On October 23, 1987, Mr. Bolski agreed that he had received credit for all payments made and therefore the notice dated June 20, 1985 will not be addressed hereinafter.

During the period at issue herein, Vebol operated a coffee shop at 109 East 59th Street, New York, New York. The coffee shop had a counter area with 18 stools and there were also tables and chairs in the back of the shop which seated an additional 70 customers. The shop was open Monday through Friday 7:00 A.M. to 5:00 P.M. and on Saturdays from 11:00 A.M. to 2:30 P.M. The shop was closed on Saturdays during July and August.

Vebol did not maintain complete and adequate books and records during the period at issue. Vebol was unable to produce cash receipts, ledgers, cash register tapes, guest checks or any other sales records for the period March 1, 1981 through December 31, 1981.

In order to verify the accuracy of reported sales, the Division, in light of the insufficiency of Vebol's books and records, resorted to the use of a two-day observation test. Using Thursday, February 16, 1984 and Tuesday, February 21, 1984 as observation dates, the Division computed average daily sales of $2,005.00. This figure was projected throughout the entire audit period and produced a total sales figure of $1,863,732.00.

The audited sales figure of $1,863,732.00 was reduced by the following amounts to arrive at audited taxable sales of $1,680,399.00:

(i) by $33,009.00 for 33 holidays (11 per year) where Vebol was closed for business. The Division considered each holiday as a Saturday, thereby producing a reduction of $1,003.00 per holiday instead of a $2,005.00 reduction had the holidays been considered weekdays.

(ii) by $115,940.09 to take into consideration inflation rates of 10 percent, 5 percent and 4 percent, respectively, per year.

(iii) by $34,294.00 to allow for nontaxable take-out sales of baked goods and fresh fruit.

The audited taxable sales figure of $1,680,399.00 was reduced by reported taxable sales to arrive at additional taxable sales of $922,065.00. The additional taxable sales figure of $922,065.00 was divided by the 12 quarters in the audit period to produce additional taxable sales per quarter of $76,838.75. Tax due on additional taxable sales amounted to $75,686.20.

Also included in the notice issued to Vebol were $1,385.97 of tax due from overcollections and $1,184.02 of tax due on cigarette sales. The tax due on overcollections was the result of a review of a portion of the guest checks for February 16, 1984 which revealed the overcollection of tax in the amount of $.51. The amount of tax overcollected was divided by the total tax due on the invoices reviewed ($22.59), which produced an error rate of 2.26 percent. Said error rate was applied to tax reported due on Vebolls returns and resulted in a tax due of $1,385.97.

During the course of the two day observation test, the auditor noted that cigarette sales were not included in sales rung up through the cash register nor were they included on guest checks. The tax due on cigarette sales was computed by applying an audited markup of 62.02 percent to audited cigarette purchases of $8,962.99. This procedure resulted in audited cigarette sales of $14,424.63 and a tax due thereon of $1,184.02.

As previously noted, Vebol was open for business on Saturdays only from 11:00 A.M. to 2:30 P.M. Sales on Saturdays totalled 25 percent of weekday sales. Also, Vebol was closed on all Saturdays during the months of July and August.

Vebol's nontaxable take-out sales of baked goods and fresh fruit averaged $250.00 per weekday and $62.50 for Saturdays. Nontaxable take-out sales totalled $17,062.50 for the quarters ended February 28, May 31, and November 30 and $16,500.00 for the quarters ended August 31.

In addition to the facts found by the Administrative Law Judge, we find that petitioners agreed to the use of an observation test audit.

OPINION

The Administrative Law Judge upheld the observation test audit performed, with modifications to some of the elements of the audit. The Administrative Law Judge reduced Saturday sales to 25 percent of weekday sales, instead of 50 percent as estimated by the Division and found that the coffee shop was closed on every Saturday during July and August. The Administrative Law Judge also increased the allowance for holiday closings finding that all holidays fell on weekdays, instead of Saturdays, and increased the allowance for certain nontaxable sales. The Administrative Law Judge found no credible evidence to waive penalty or reduce interest.

On exception petitioners attack the audit methodology generally, asserting that the two-day observation test was not reasonably designed to estimate the taxes due from the petitioners. The petitioners also specifically object that the Administrative Law Judge did not allow enough holidays and that the tax due on overcollections was improperly determined.

We affirm the determination of the Administrative Law Judge.

Petitioners do not challenge the Division's right to resort to an indirect audit method in this case. It is undisputed that petitioners' sales records were inadequate, thus the use of an indirect audit method was appropriate (Licata v. Chu, 64 NY2d 873). Instead, the petitioners assert that the method employed, a two-day observation test, was not reasonably designed to estimate the taxes due.

Petitioners have alleged on exception that the corporate petitioner had a complete set of purchase invoices upon which a markup audit could have been performed. Petitioners contend that such an audit would have been a better means to estimate taxes and thus, use of an

observation test was unreasonable. In essence, petitioners argue that an observation test should be the audit method of last resort.

The recent decision in Meskouris Brothers v. Chu (139 AD2d 813) upheld the use of such a two-day observation test, at least where the taxpayer's records were so deficient that this auditing method was "virtually the only technique" available to estimate the tax. The two-day observation test was determined reasonable by the Appellate Division given the abysmal state of the taxpayer's records, notwithstanding the taxpayer's expert testimony that such a method was statistically inadequate.

The petitioners' theory that an observation audit should be the audit of last resort, is supported by the Meskouris decision. In the State Tax Commission determination under review by the court in Meskouris, the Commission found that the taxpayer did not have a reliable set of purchase invoices. The Commission stated that the requirement to “choose an audit method reasonably calculated to reflect tax due must be considered in view of the information made available to it to estimate liability." (In the Matter of Meskouris Brothers, Inc., State Tax Commission, September 15, 1986.) Clearly, the lack of purchase invoices was a significant factor in making the observation test the only audit method available and thus, reasonable, given the circumstances.

While petitioners' theory may have merit, they cannot benefit from this theory on the instant facts for two reasons. First, the record indicates that the petitioner, Edward Bolski, admitted at the hearing that he orally agreed to an observation test, although not to the particular days observed. Certainly, the taxpayer's agreement to the audit methodology supports the Division's use of it.

Second, our review of the record indicates that petitioners have not proved that they had a complete set of reliable purchase invoices (see, Matter of Bonanno v. State Tax Commn., Supreme Court, Appellate Division, 3rd Dept, December 1. 1988, J. Mercure) that were ignored by the Division at the time of the audit. Failing to prove the existence of such records, petitioners certainly have not proved that the instant audit's failure to utilize such records was erroneous. Petitioners' burden is to establish by clear and convincing evidence that the audit method was erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858). The petitioners have failed to satisfy this burden in their general attack on the audit. On the basis of the Meskouris decision, we must sustain the use of the observation test here, notwithstanding its inexactness.

With respect to their specific objections to the audit, petitioners allege that the two days observed were not typical of the business activity. The record indicates that petitioners did not introduce any documentary evidence to support their claim that the days were not representative, nor any evidence to show the effect on the audit results if "typical" days were utilized. Accordingly, we find that petitioners have failed to show by clear and convincing evidence that the amount assessed was erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, supra).

We also find no error in the number of holidays allowed by the Administrative Law Judge (11 per year). Again, petitioners failed to produce sufficient evidence to prove that the coffee shop was closed on more than 11 holidays per year.

Petitioners' last challenge is that the tax assessed on overcollections was based on an inadequate sampling of invoices. The record indicates (Dept. Exhibit N) that the overcollection

of tax was based on a review of 63 invoices from February 16, 1984 stating taxable sales of $273.98, tax collected of $22.90, tax due of $22.89, and thus an overcollection of $.51. Although the Division's failure to review all of the sales invoices for even one day of the observation test is not immune from criticism, the petitioners have not demonstrated that such a review would have yielded a different result. Therefore, we conclude that petitioners have not proved that they are entitled to an adjustment to this portion of the audit.

Accordingly, it is ORDERED, ADJUDGED and DECREED that

1. The exceptions of petitioners Vebol Edibles, Inc. d/b/a Hickory House and Edward Bolski, Officer of Vebol Edibles, Inc. d/b/a Hickory House are denied;

2. The determination of the Administrative Law Judge is sustained;

3. The petitions of Vebol Edibles, Inc. d/b/a Hickory House and Edward Bolski. Officer of Vebol Edibles, Inc. d/b/a Hickory House are granted to the extent indicated in conclusions of law "B", "C", "D", "E" and "H" of the Administrative Law Judge's determination and the Division of Taxation is directed to recompute the notices of determination, dated September 20, 1984, accordingly but, except as so granted, the petitions are in all other respects denied; and

4. The petition of Edward Bolski, Officer of Vebol Edibles, Inc. d/b/a Hickory House for revision of the Notice of Determination dated June 20, 1985 is in all respects denied.

Dated: Albany, New York
January 12, 1989

/s/ John P. Dugan
President

/s/ Francis R. Koenig
Commissioner