

STATE OF NEW YORK  
TAX APPEALS TRIBUNAL

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In the Matter of the Petition	:	
of	:	
<b>BAGEL NOOK, INC.</b>	:	DECISION
<b>AND LEO VITTORIO, AS OFFICER</b>	:	DTA No. 802190
	:	and 802391
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 1980	:	
through August 31, 1984.	:	

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Petitioners Bagel Nook, Inc. and Leo Vittorio, as Officer, 247 West 12th Street, New York, New York 10014, filed an exception to the determination of the Administrative Law Judge issued on July 1, 1993. Petitioner appeared by Barry L. Shoemson, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Gary Palmer, Esq., of counsel).

Petitioners did not file a brief on exception. The Division of Taxation submitted a letter in lieu of a brief. Petitioners had until February 15, 1994 to file a reply brief, which date began the six-month period for the issuance of this decision.

The Tax Appeals Tribunal renders the following decision per curiam.

***ISSUES***

I. Whether, for the period at issue, the Division of Taxation properly determined additional sales and use taxes due from Bagel Nook, Inc.

II. Whether petitioner Leo Vittorio was, pursuant to the provisions of Tax Law §§ 1131(1) and 1133(a), a person required to collect sales and use taxes on behalf of Bagel Nook, Inc. and, as such, was properly held to be personally liable therefor.

***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Pursuant to a field audit of Bagel Nook, Inc. ("Bagel Nook") which commenced in February 1983, the Division of Taxation ("Division"), on March 20, 1985, issued two notices of determination and demands for payment of sales and use taxes due to Bagel Nook as follows:

<u>Period</u>	<u>Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total Due</u>
6/1/80 - 11/30/83	\$123,246.78	\$30,073.80	\$52,409.39	\$205,729.97
12/1/83 - 8/31/84	22,072.48	2,870.27	2,080.33	27,023.08

On the same date, the Division issued notices of determination, for the identical periods and in the identical amounts, to Leo Vittorio, as officer of Bagel Nook.

Previously, consents extending the period of limitation for assessment of sales and use taxes, all of which bore what purported to be the signature of Leo Vittorio, as vice-president, were executed as follows:

<u>Date Executed</u>	<u>Period Extended</u>	<u>Date for Assessment</u>
9/9/83	6/1/80 - 8/31/80	12/20/83
12/9/83	6/1/80 - 11/30/80	3/20/84
3/6/84	6/1/80 - 2/28/81	6/20/84
5/24/84	6/1/80 - 5/31/81	9/20/84
8/23/84	6/1/80 - 8/31/81	12/20/84
12/7/84	6/1/80 - 11/30/81	3/20/85

The auditor met with petitioners' representatives, Richard Stein and Matthew Feigenbaum, at which time he orally requested books and records to perform an audit of Bagel Nook. The auditor requested cash register tapes, guest checks, cash receipts and disbursements journals, bank statements and other records pertaining to sales and use tax liabilities for the audit period.

Records made available included sales tax returns and related worksheets, Federal income tax returns and related worksheets, cash receipts and disbursements journals, purchase invoices, general ledger and monthly bank statements. No register tapes, guest checks or other original source documents were provided. Based upon the lack of original source documents to verify the vendor's sales, the auditor determined that Bagel Nook's records were insufficient for the performance of a detailed audit.

The auditor compared sales per returns with sales per cash receipts and found them to be in agreement. An examination of the cash receipts journal indicated that deposits were substantially greater than reported sales, which discrepancy the vendor attributed to loans and exchanges. The auditor analyzed reported sales and found them to be "quite low for this type of establishment."<sup>1</sup>

Bagel Nook had no fixed asset acquisitions during the audit period. However, for a major repair costing \$10,492.00, the vendor was unable to substantiate that tax thereon had been paid, so tax in the amount of \$865.59 was assessed.

Bagel Nook's purchase of paper products was analyzed for the sales tax quarter ended August 31, 1982 (purchases for each month through May 1983 were transcribed; records for the period June 1, 1983 through August 31, 1984 were not available) wherein it was determined that 36% of such paper products (napkins, stirrers, straws and plastic utensils) were subject to tax. The auditor applied this percentage to total paper supplies purchased for the audit period, resulting in additional purchases subject to tax in the amount of \$78,623.00. Tax of \$6,427.23 was, therefore, assessed on these paper product purchases.

To analyze Bagel Nook's sales, the auditor decided to utilize an observation test. Initially, the auditor attempted to perform an observation test on May 9, 1984, but the assistant manager would not permit it. Through subsequent conversations with Mr. Feigenbaum, the auditor was advised that someone could be at the premises to assist the auditors on a Monday or Tuesday. An observation test was performed on August 2, 1984. The primary auditor (Lance Sonners) and another auditor (George Berkowitz) performed the audit from 7:00 A.M. until 5:00 P.M., at which time two other auditors conducted the audit until midnight. Total sales observed (7:00 A.M. until 12:00 midnight) were in the amount of \$2,331.98, with taxable sales of \$1,470.77, representing a taxable percentage of 63%.

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<sup>1</sup>It should be noted that the auditor testified that he had no prior experience in auditing bagel restaurants, although he stated that he had audited many restaurants.

A second observation test was performed on October 16, 1984, between the hours of 7:00 A.M. and 4:00 P.M. Total sales for this period were observed to be \$1,532.04, with taxable sales in the amount of \$1,262.54. In order to determine taxable sales for the time period 4:00 P.M. until 12:00 midnight, the auditor divided gross sales per observation on October 16, 1984 from 7:00 A.M. until 4:00 P.M. (\$1,532.04) by gross sales per observation on August 2, 1984 from 7:00 A.M. until 4:00 P.M. (\$1,792.48), with the result being 85.47%. Gross sales observed on August 2, 1984 from 4:00 P.M. until 12:00 midnight (\$539.50) were multiplied by this percentage to get projected gross sales of \$461.11. On August 2, 1984, from 4:00 P.M. until 12:00 midnight, taxable sales represented 77.16% of gross sales. Accordingly, projected gross sales of \$461.11 was multiplied by 77.16% to arrive at projected taxable sales of \$355.79 for October 16, 1984 from 4:00 P.M. until 12:00 midnight. Gross sales for October 16, 1984 were, therefore, projected to be \$1,993.15 ( $\$1,532.04 + \$461.11$ ) and taxable sales were projected to be \$1,618.33 ( $\$1,262.54 + \$355.79$ ), a taxable percentage of approximately 81%.

The auditor then averaged gross sales for the two observations ( $\$2,331.98 + \$1,993.15 = \$4,325.13$  divided by 2 = \$2,162.57) and, likewise, averaged taxable sales ( $\$1,470.77 + \$1,618.33 = \$3,089.10$  divided by 2 = \$1,544.55) and the percentage of taxable sales was found to be 71.42% ( $\$1,544.55$  divided by  $\$2,162.57$ ).

Bagel Nook reported gross sales, for the quarter ended August 31, 1984, in the amount of \$105,825.00. By dividing this figure by the number of days in the quarter (92), average reported gross sales per day were determined to be \$1,150.00. Reported gross sales per day (\$1,150.00) were then subtracted from the average gross sales per day per the observation tests (\$2,163.00) with the result (\$1,013.00) being the increase in gross sales per day. The percentage increase in gross sales was, therefore, found to be 88.09% ( $\$1,013.00$  divided by  $\$1,150.00$ ).

Gross sales reported for the audit period (\$2,208,109.00) were then multiplied by 88.09% and the result, when added to reported gross sales, was projected gross sales of \$4,153,233.00. To determine taxable sales, projected gross sales were multiplied by the aforementioned average taxable percentage of 71.42% to arrive at taxable sales in the amount of \$2,966,239.00 for the

audit period. Reported taxable sales of \$1,275,268.00 were subtracted therefrom, leaving additional taxable sales of \$1,690,971.00 which, when multiplied by the applicable tax rate (8 or 8¼%), resulted in additional tax due of \$138,026.44.

Tax due on sales (\$138,026.44) was added to tax due on paper product purchases (\$6,427.23) and tax due on non-recurring expenses (\$865.59) to arrive at total tax due for the audit period in the amount of \$145,319.26 which was the amount assessed in the notices of determination issued by the Division to each petitioner (see, above).

At the hearing, the auditor testified that there were two cash registers, one which was used mostly for nontaxable items and the other which was used totally for taxable items. This testimony was based upon his observations and also upon what he was told by the manager. The figures (for taxable and nontaxable) were obtained from examining cash register readings rather than from an item-by-item analysis of each sale made during the observation test. The cash register readings were made by Mr. Sonners, Mr. Berkowitz and by several other auditors who assisted during the two days of observation.

The auditor never inquired as to the hours of operation of Bagel Nook, but used the hours of 7:00 A.M. until 12:00 midnight because these were the hours during which an observation was made on August 2, 1984. The periodic breakdown was as follows:

<u>Time</u>	<u>% Taxable (8/2/84)</u>	<u>% Taxable (10/16/84)</u>
7:00 A.M. - 11:30 A.M. (breakfast)	52	70
11:30 A.M. - 2:00 P.M. (lunch)	65	92
2:00 P.M. - 4:00 P.M. (mid-afternoon)	52	83
4:00 P.M. - 8:00 P.M. (dinner)	73	not observed

The auditor testified that Leo Vittorio was assessed because he signed the sales tax returns, as vice-president, on behalf of Bagel Nook. The return for the quarter ended November 30, 1980 contained the signature of Leo Vittorio, President. In addition, he stated that he was informed by Barry Shoelmonson, Bagel Nook's accountant, that Leo Vittorio was the only officer of the corporation.

Petitioner Leo Vittorio testified that he and his wife came up with the idea of putting together a deli with a bagel store and, in 1972, he opened the first Bagel Nosh at 21st Street and 3rd Avenue in New York City. Soon after, other Bagel Nosh stores opened at 76th Street and 1st Avenue and at 38th Street and 3rd Avenue.

Leo Vittorio stated that a long-time friend, Tom Quinn, operated these stores and, in or about 1973, formed the corporation, Bagel Nosh, Inc. It was Mr. Vittorio's belief that Tom Quinn's wife was the sole shareholder of Bagel Nosh, Inc., while Tom Quinn, in essence, ran the company. Mr. Vittorio admitted, however, that he was issued shares and became an officer in Bagel Nosh, Inc.

Mr. Vittorio testified that, in or about 1973, he "wanted to get away from New York State and go to Florida," although he provided no explanation therefor. He stated that he went to Florida and "put up some Bagel Nosh units there." From 1973 until approximately 1979, he traveled around the country finding new locations for Bagel Nosh franchises and helping the new franchisees to get started. During that time, he resided in Miami, Florida.

In 1979, Leo Vittorio decided to return to New York and, at that time, he became president of Bagel Nosh, Inc. and a 50% owner therein. He became responsible for the operations area of Bagel Nosh, Inc., i.e., selling franchises (locating sites, supervising construction, approving franchisees) and, after the store opened, training employees and providing initial in-store supervision. During its peak, there were approximately 58 or 59 Bagel Nosh franchises throughout the United States and Leo Vittorio spent the majority of his time in the Bagel Nosh, Inc. offices and overseeing the operations of these franchisees.

Leo Vittorio testified that the Bagel Nook store, which opened in 1975, was a franchisee of Bagel Nosh, Inc. and that Bagel Nook was owned by Tom Quinn. Mr. Vittorio stated that Tom Quinn was its sole shareholder, but, at some point, Quinn made him an officer (vice-president) and gave him check-signing authority. At the hearing held on June 23, 1991, he stated that he received no salary from Bagel Nook until 1987; however, at the hearing held on January 28,

1992, he amended his answer by stating that he received a salary from Bagel Nook from the beginning of 1984 until 1990, when Bagel Nook ceased operation.

Mr. Vittorio stated that while Tom Quinn owned Bagel Nook, he did not operate it. A manager was hired to oversee the store's day-to-day operation. In 1980, Tom Quinn began going to Europe for extended periods and, in 1982, he left the United States permanently to reside in France. When Mr. Quinn left, he did not want Bagel Nook's checks signed by anyone who could take money from the business. Therefore, he made Leo Vittorio an officer (vice-president) and gave him check-signing authority.

Mr. Vittorio testified that a signature stamp was prepared and that he authorized the store manager (Yehia was the manager during the audit period) to use the stamp on Bagel Nook checks. He stated that he did not review the checks for amounts, payees, etc., but permitted the stamp to be used so bills could be paid and the business could remain operative. His only involvement with the business, he contends, was in his capacity with Bagel Nosh, i.e., he investigated complaints and spoke to the manager about quality control and would, on occasion, recommend the discharge of certain employees although the final decision rested with the manager.

Leo Vittorio received approximately \$300.00 to \$400.00 per week as salary from Bagel Nook in 1984 and, by 1986 or 1987, his salary was increased to approximately \$800.00 per week. He stated that, in or about 1987, his involvement with Bagel Nook increased and that he began dealing with employees on a more frequent basis.

After Tom Quinn left the United States, he showed little or no interest in Bagel Nosh, Inc. because the business was declining steadily. As for Bagel Nook, Mr. Vittorio does not know what, if any, contacts Quinn maintained with the store manager.

At the hearing held on June 23, 1991, the Division's representative, during his cross examination of Leo Vittorio, showed Mr. Vittorio various documents containing what appeared to be his signature. The following is a list of such documents and Mr. Vittorio's response to questions from the Division's representative as to whether the signature was, in fact his:

<u>Exhibit</u>	<u>Document</u>	<u>Vittorio's Signature</u>
B	Corp. Power of Attorney	No; later changed to yes
C	Indiv. Power of Attorney	No; later changed to yes when attorney pointed to acknowledgement
D	Consents (6)	Nos. 2, 3, 5 & 6 - Yes Nos. 1 & 4 - Maybe
K	Sales Tax Returns (7)	No
L	Payroll Checks	Pg. 1 - No (was stamped) Pg. 3 - 3 checks - Yes for last check on page
N	Sales Tax Returns (6)	No
O	Sales Tax Registration	No
Q	Application for Extension (Federal)	Maybe
R	Signature at Hearing	Yes

Following the June 23, 1991 hearing, the Division's representative sought permission from the Administrative Law Judge (such permission was granted) to have a forensic scientist from the New York State Police examine all of the exhibits which contained what appeared to be the signature of Leo Vittorio (both the documents which Mr. Vittorio admitted bore his signature and documents which he either denied or was unsure contained his signature).

The report of Dwight R. Howes, Forensic Scientist III, was admitted into evidence as Exhibit "S". Mr. Howes' qualifications and experience are set forth in the report. In his opinion, the Certificate of Registration (Exhibit "O") was not signed by Leo Vittorio, but that he did sign sales tax returns (Exhibit "K") for the period September 1, 1980 through August 31, 1981. Because of similar characteristics between the known signatures of Leo Vittorio and the signatures on the questioned consents (Exhibit "D"), checks (Exhibit "L"), sales tax returns for the period September 1, 1983 through August 31, 1984 (Exhibit "N") and the Application for Extension (Exhibit "Q"), Mr. Howes feels that, in all probability, Mr. Vittorio executed these documents. As for sales tax returns for the period September 1, 1981 through August 31, 1983, while Mr. Howes could not eliminate Leo Vittorio from having executed the documents, there were some discrepancies which he could not account for.

Barry Shoemson, C.P.A., who was the comptroller for Bagel Nosh, Inc. from 1974 through a portion of 1982, was responsible for the financial and accounting aspects of the franchising operations and the financial supervision of the franchise stores. In the course of his

duties, he reviewed the operations of Bagel Nook, one of the franchisees. After he left his employment with Bagel Nosh, Inc., he became the outside accountant for Bagel Nook.

Mr. Sholemson testified that Leo Vittorio was responsible for the operations area of Bagel Nosh, Inc. after returning to New York in 1979.

Mr. Sholemson stated that the sole shareholder of Bagel Nook was Tom Quinn. During the audit period, Bagel Nook's manager, Yehia, sent weekly sales reports to Bagel Nosh, made bank deposits, ordered supplies and made decisions with respect to the hours of operation and what was sold. He assumes that Yehia hired and fired employees, although he does not know that for certain. He also does not know how many shares of stock in Bagel Nook were issued or how many were held by Tom Quinn nor does he know who, on behalf of Bagel Nook, executed the franchise agreement. Mr. Sholemson would visit the store once per month to reconcile bank statements, prepare and write up receipts and disbursements and prepare the required tax returns.

He testified that Bagel Nook did not use guest checks and that register tapes for the audit period could not be located. Mr. Sholemson stated that he normally took averages in making projections (sales tax returns) and that the figure of 53 to 54% was used. He prepared the sales tax returns and he "believes" that the manager signed them. Franchise tax reports were signed by either Yehia or by Leo Vittorio.

#### ***OPINION***

The Administrative Law Judge found that the Division was justified in resorting to external indices to estimate the tax due as petitioners did not produce any cash register tapes or guest checks. In addition, relying in part on Matter of Vebol Edibles v. State of New York Tax Appeals Tribunal (162 AD2d 765, 557 NYS2d 678, lv denied 77 NY2d 803, 567 NYS2d 643), the Administrative Law Judge found that the use of an observation test, even a two-day observation test, was a reasonable audit method. The Administrative Law Judge stated, in response to petitioners arguments that a longer observation test would have more accurately portrayed the Bagel Nook's business or that a test done on a weekend or during the winter months might have produced a different result, that petitioners did not submit any proof to refute the

Division's observation tests. The Administrative Law Judge, citing Matter of Grecian Sq. v. New York State Tax Commn. (119 AD2d 948, 501 NYS2d 219), then stated that the "Division is not required to select the most accurate audit method, but merely a rationally based one, which it has done" (Determination, conclusion of law "B").

Turning to the responsible officer issue, the Administrative Law Judge found that petitioner Leo Vittorio was a person required to collect sales and use taxes on behalf of the corporation pursuant to Tax Law §§ 1131(1) and 1133(a). Specifically, the Administrative Law Judge found that Leo Vittorio was an officer of Bagel Nook, possessed check signing authority and signed corporate checks, signed sales tax returns on behalf of Bagel Nook and received a salary from Bagel Nook. In addition, the Administrative Law Judge found that petitioner made recommendations concerning the operations and employees of Bagel Nook through his position with Bagel Nosh, Inc. The Administrative Law Judge determined that petitioner Leo Vittorio attempted to delegate his authority or duties to others by the use of a signature stamp and that a corporate officer "cannot absolve himself merely by disregarding his duty and leaving it to someone else to discharge (see, Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536; Matter of Ragonesi v. New York State Tax Commn., 88 AD2d 707, 451 NYS2d 301)" (Determination, conclusion of law "C").

On exception, petitioners continue to argue that the two-day observation test was not a reasonable audit method. Petitioners argue that the results of the observation test produced inaccurate results and that a two-day observation test should not be applied to a period of more than four years. Petitioners also continue to argue that there is not sufficient evidence to find petitioner Leo Vittorio personally liable for the collection and payment of sales and use taxes on behalf of the corporation.

In response, the Division relies on its brief below and asks that the Administrative Law Judge's determination be affirmed and the notices of determination be sustained.

On exception, petitioners have raised the same arguments made before the Administrative Law Judge. Because the Administrative Law Judge adequately addressed these arguments, we

affirm the determination of the Administrative Law Judge for the reasons stated in said determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Bagel Nook, Inc. and Leo Vittorio, as Officer is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Bagel Nook, Inc. and Leo Vittorio, as Officer is denied; and
4. The notices of determination issued on March 20, 1985 are sustained.

DATED: Troy, New York  
July 21, 1994

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

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