

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
MERA DELICATESSEN, INC.	:	DECISION
AND EMIL MEKHAIL, AS OFFICER	:	
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 September 1, 1982	:	
through February 28, 1985	:	

Petitioners, Mera Delicatessen, Inc. and Emil Mekhail, as officer, 32-43 86th Street, Jackson Heights, New York 11369-2144, filed an exception to the determination of the Administrative Law Judge issued on February 9, 1989 with respect to their 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 September 1, 1982 through February 28, 1985 (File No. 802775). Petitioners appeared by Emil Mekhail. The Division of Taxation appeared by William F. Collins, Esq. (Michael Gitter, Esq., of counsel).

Petitioners did not file a brief on exception. The Division submitted a letter in lieu of a brief. Petitioners' request for oral argument was denied.

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

ISSUE

Whether the Division properly based its determination on an estimated audit consisting of an observation test of petitioners' business.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge and such facts are restated below.

On November 14, 1985, the Division of Taxation issued two notices of determination and demands for payment of sales and use taxes due to petitioner Mera Delicatessen, Inc. ("Mera"), spanning, together, the period September 1, 1982 through February 28, 1985 and assessing a sales tax liability in the aggregate amount of \$79,767.02, plus penalty (Tax Law § 1145 former [a][1]) and interest. On the same date, the Division of Taxation issued two additional notices of determination and demands for payment of sales and use taxes due spanning the same period and assessing the same amounts as above, against petitioner Emil Mekhail as a person required to collect and remit taxes on behalf of Mera. These four notices were all based on the results of a field audit of the business operations of Mera as described hereinafter.

In or about November of 1984, the Division of Taxation determined to conduct a field audit of Mera's business operations. An auditor was assigned and an audit appointment letter scheduling an audit for November 19, 1984 was mailed to Mera. This appointment letter specified the audit period to be September 1, 1982 through August 31, 1984, and indicated that all records pertaining to Mera's sales tax liability should be available for review including, but not limited to, journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and any other sales tax records.

On August 27, 1984, prior to the issuance of the audit appointment letter, the auditor made an unannounced visit to the premises. The auditor observed the premises, located in Times Square (8th Avenue at 43rd Street), to consist of a coffee and sandwich shop selling coffee, rolls, sandwiches (ham, cheese, salami, tuna fish, etc.), cold cuts, beer, soda and other similar items. The auditor described the premises as relatively small in area, and also observed a sign attached to the door of the premises indicating the business was open 7 days per week, 24 hours per day. Petitioners purchased and commenced operation of this business in 1982. Prior to petitioners' purchase, a small delicatessen was operated at the premises. Petitioners initially paid \$1,200.00 per month to rent the premises, with such rent later increased to \$1,500.00 per month.

On the November 19, 1984 audit appointment date, the auditor went to the business premises. The only records made available to the auditor were certain bank statements, and a small portion of a cash receipts journal and a cash disbursements journal. There were no cash register tapes, guest checks, sales or purchase invoices, Federal income tax returns or withholding tax returns available.

Given the presentation of the limited records described above, the auditor concluded that Mera had inadequate books and records for purposes of conducting a detailed audit and therefore determined to resort to indirect audit methodologies. More specifically, the auditor conducted an observation of the premises on April 4, 1985 between the hours of 7:00 A.M. and 6:30 P.M. Although the business was allegedly open 24 hours per day, the business was closed abruptly at 6:30 P.M. on the day of the observation and the observation was, at that point, terminated. After such closing, the auditor visited other establishments in the area, questioned certain persons there, and was advised that Mera was open 24 hours per day, 7 days per week.

During the course of the observation the auditor totalled all sales made, including both taxable and nontaxable sales. The auditor recorded \$491.41 in taxable sales during the period from 7:00 A.M. to 6:30 P.M. Thereafter, the auditor doubled this amount of sales to account for the period spanning 7:00 P.M. to 7:00 A.M. In addition, the auditor observed delivery orders received by telephone at the premises. While no deliveries were made on the observation day due to illness of the delivery boy employed by Mera, the auditor assumed that on an ongoing basis delivery sales were made and thus added 10 percent (based upon prior audit experience) to the amount of sales observed to account for delivery sales. Accordingly, total taxable daily sales were determined to be \$1,081.10. The auditor then projected said amount over 7 days per week and 13 weeks per sales tax quarterly period (or 130 weeks in the 10 quarters covered by the notice of determination) to arrive at total taxable sales. The auditor compared this total to the total taxable sales reported per Mera's sales tax returns, and arrived at a \$966,873.00 increase over taxable sales reported, with additional tax due computed thereon in the amount of \$79,767.02. In turn, the notices of determination described above were issued to petitioners.

The auditor recommended that penalty be assessed based primarily on the lack of records and the comparison of reported taxable sales by Mera (\$44.00 per day) versus taxable sales determined upon audit (\$1,081.10 per day).¹

At hearing, petitioner Emil Mekhail admitted that he was a person required to collect and remit sales and use taxes on behalf of Mera during the period in question. However, petitioners contest the dollar amount of sales tax as determined upon audit.

Petitioner Emil Mekhail appeared and testified at hearing, and also presented some limited documentary evidence, including photographs of the premises and letters from some of Mera's suppliers reflecting dollar amounts of purchases by Mera during 1985.

OPINION

In the determination below the Administrative Law Judge found that the audit methodology utilized by the Division in conducting its audit of the petitioners' business was proper. Specifically, the Administrative Law Judge concluded that the resort to external indices, namely, an observation test to determine the petitioners' liability, was warranted and adequately conducted. In their exception, the petitioners state that they disagree with the Administrative Law Judge's Findings of Fact "1" and "4" and with Conclusions of Law "A", "B" and "C" but have not specifically stated what it is about these findings of fact and conclusions of law with which they disagree. In response, the Division issued a letter agreeing with the determination of the Administrative Law Judge and requesting that the petitioners' exception be dismissed.

We affirm the determination of the Administrative Law Judge.

As a vendor of food and beverages, petitioners were responsible for collecting sales tax on their retail sales (Tax Law §§ 1105[d][i], 1132[a]). Petitioners were also obligated to keep records of every sale and the tax due thereon, including "a true copy of each sales slip, invoice, receipt, statement or memorandum" (Tax Law § 1135[a]) upon which the sales "tax shall be stated, charged and shown separately on the first of such documents given to (the purchaser)" (Tax Law § 1132[a]).

¹Gross sales reported by Mera for the entire period covered by the notices of determination totalled \$17,270.00.

The Division has the authority to determine "from such information as may be available", the amount of tax actually due from a taxpayer for a given period when any one of its sales tax returns is either not filed or stated an incorrect or insufficient amount of tax due (Tax Law § 1138[a][1]). When the vendor maintains a comprehensive set of books and records, "such information as may be available" (Tax Law § 1138[a][1]) is restricted to his books and records, and not external indicia, because "the honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability" (Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41, 43).

To determine the adequacy of a taxpayer's records, the Division must first request (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978, 979-80) the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828). The purpose of the examination is to determine, through verification drawn independently from within these records (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv. denied 44 NYS2d 645, 406 NYS2d 1025; Matter of Giordano, B&G v. State Tax Commn., 125 AD2d 726, 535 NYS2d 255, 256-257; Matter of Urban Liquors, Inc. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139; see also, Matter of Hennekens v. State Tax Commn., 114 AD2d 599, 494 NYS2d 208, 209), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (Chartair, Inc., supra, at 43; Matter of Christ Cella v. State Tax Commn., supra,) "from which the exact amount of tax can be determined" (Matter of Mohawk Airlines, Inc. v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (Matter of Urban Liquors, Inc. v. State Tax Commn., supra). The estimate methodology utilized must be reasonably calculated to reflect taxes due, but exactness is not required from such a method

(Matter of W.T. Grant Company v. Joseph, 2 NY2d 207, 159 NYS2d 150, 157; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177).

We first address the petitioners' disagreement with Findings of Fact "1" and "4".² Finding of Fact "1" relates to the notices of determination and demand that were introduced at the hearing. Finding of Fact "4" pertains to the records which the petitioners made available to the Division of Taxation upon request. It notes the lack of cash register tapes, guest checks, sales or purchase invoices, Federal income tax returns or withholding tax returns available. After thorough examination of the record and items put into evidence we find the Administrative Law Judge's Findings of Fact "1" and "4" to be valid and accurate, and, therefore, the petitioners' challenge to be without merit.

We next consider the petitioners' disagreement with Conclusions of Law "A", "B" and "C". Since the petitioners have not stated specific reasons for their dispute, we will look at each conclusion separately and assess its validity.

Conclusion of Law "A" puts forward nothing more than a synopsis of what §§ 1135, 1142.5 and 1138 of the Tax Law require of the taxpayer and when the Division is authorized to use external indices in conducting an audit. This synopsis is consistent with our statement of the law above.

Conclusion of Law "B" relates to the petitioners' failure to maintain adequate books and records, and the Division's subsequent resort to external indices in the form of an observation test. On the record before us we conclude that petitioners' books and records were so insufficient as to make the observation test virtually the only means available to the Division to estimate tax

²The Administrative Law Judge's Findings of Fact "1" and "4" are as follows: 1. On November 14, 1985, the Division issued two notices of determination and demands for payment of sales and use taxes due to petitioner Mera Delicatessen, Inc. ("Mera"), spanning, together, the period September 1, 1982 through February 28, 1985 and assessing a sales tax liability in the aggregate amount of \$79,767.02, plus penalty (Tax Law § 1145 former [a][1]) and interest. On the same date, the Division issued two additional notices of determination and demands for payment of sales and use taxes due spanning the same period and assessing the same amounts as above, against petitioner Emil Mekahil as a person required to collect and remit taxes on behalf of Mera. These four notices were all based on the results of a field audit of the business operations of Mera as described hereinafter.

4. On the November 19, 1984 audit appointment date, the auditor went to the business premises. The only records made available to the auditor were certain bank statements, and a small portion of a cash receipts journal and a cash disbursements journal. There were no cash register tapes, guest checks, sales or purchase invoices, Federal income tax returns or withholding tax returns available.

liability (Matter of Meskouris Brothers, Inc. v. Chu, 139 AD2d 813, 526 NYS2d 679; cf., Matter of Cafe Europa, Tax Appeals Tribunal, July 13, 1989). Accordingly, we agree with the Administrative Law Judge's conclusion that a resort to external indices and the use of the observation test in particular was appropriate.

Lastly, the petitioners have challenged the Administrative Law Judge's Conclusion of Law "C", which sets out the reasons why the petitioners had not presented evidence sufficient to either refute the audit methodology or allow reduction of the amount of tax or penalty determined to be due for the period under audit. The petitioners had offered at hearing several assertions as to why the tax was incorrectly determined. However, as pointed out by the Administrative Law Judge, none of these assertions were offered with specificity, nor were they presented with supporting documentation sufficient to allow any reasonably accurate determination or reduction to be derived therefrom. Given the fact that the taxpayers failed to maintain the requisite books and records necessary to conduct an audit, the methodology used here was reasonable under the circumstances and exactness was not required (see, Matter of Meskouris Brothers, Inc. v. Chu, supra; see also, W.T. Grant Company, supra). In total, we find the petitioners' exception as to Conclusions of Law "A", "B" and "C" to be unfounded.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioners Mera Delicatessen, Inc. and Emil Mekhail, as officer, is in all respects denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Mera Delicatessen, Inc. and Emil Mekhail, as officer, is granted to the extent indicated in the Administrative Law Judge's Conclusions of Law "D" and "E", but is otherwise denied; and
4. The Division of Taxation shall modify accordingly the notices of determination and demand dated November 14, 1985 but such notices are otherwise sustained.

DATED: Troy, New York
November 2, 1989

/s/John P. Dugan
John P. Dugan

President

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

/s/Maria T. Jones
Maria T. Jones
Commissioner