

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

GEORGE, ISMINI AND NICHOLAS SARANTOPOULOS : DECISION
OFFICERS OF TAK 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, 1981 through May 31, 1985.

Petitioner Nicholas Sarantopoulos,¹ Officer of TAK Diners, Inc., 36 Colfax Avenue, Staten Island, New York 10306, filed an exception to the determination of the Administrative Law Judge issued on May 31, 1990 with respect to his petition 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, 1981 through May 31, 1985 (File Nos. 803070, 803071 and 803072). Petitioner appeared by Thomas Torto, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Gary Palmer, Esq., of counsel).

Petitioner filed a brief on exception and a reply brief in response to the Memorandum of Law filed by the Division of Taxation. Oral argument, requested by petitioner, was denied.

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

ISSUE

Whether the Division of Taxation properly determined, based upon a one-day observation audit of TAK Diners, Inc. sales, that TAK Diners, Inc. owed additional sales tax.

¹Although an exception was filed by Nicholas Sarantopoulos ostensibly covering all three petitioners, the Administrative Law Judge granted the petitions of George and Ismini Sarantopoulos and no issue has been raised with respect to this aspect of the Administrative Law Judge's determination, accordingly this opinion addresses only the petition of Nicholas Sarantopoulos.

FINDINGS OF FACT

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

On December 18, 1985, the Division of Taxation issued notices of determination and demands for payment of sales and use taxes due to petitioners, George, Ismini and Nicholas Sarantopoulos, for the period December 1, 1981 through May 31, 1985 and assessing each a sales tax liability of \$135,293.21, plus penalty (Tax Law § 1145 [former (a)(1)]) and interest. The notices indicated that petitioners were personally liable as officers of TAK Diners, Inc. ("TAK" or "the corporation") for taxes determined to be due from the corporation. The notices were based upon the results of a field audit of the business operations of TAK as described hereinafter.

On August 9, 1984, the auditor made a visit to the business premises. The premises consisted of a diner with four separate dining areas: a large dining room with a seating capacity of 80; a smaller dining room with a seating capacity of 50; a booth area with a seating capacity of 40; and a counter with a seating capacity of 16. During the audit period and at the time of the audit, the business premises were open 7 days a week, 24 hours a day. The business began operation in February 1982. After being advised to contact TAK's accountant, Mr. Richard M. Prinzi, CPA, in order to conduct the audit, the auditor orally requested that the accountant provide TAK's purchase invoices, cash register tapes, guest checks and Federal income tax returns for the entire period of the business's operation.

The auditor was initially provided with TAK's Federal income tax returns for the period February 1, 1982 through September 30, 1982 and for the fiscal year ended September 30, 1983. In addition, the auditor was provided with daily summary sheets showing the gross sales of the corporation. The auditor was informed by the accountant that the corporation had not maintained any formal ledgers, purchase invoices, cash register tapes or guest checks since it began operations.

In reviewing the records provided, the auditor determined that the filed sales tax returns were consistent with the daily summary sheets. The auditor then compared the total of TAK's gross sales as reported on the Federal income tax returns for the period February 1, 1982 through September 30, 1982 and for the fiscal year ended September 30, 1983 with the total of TAK's gross sales as reported on the sales tax returns for the period December 1, 1981 through August 31, 1983. The comparison revealed that TAK had understated gross sales on the sales tax returns by \$342,451.00 for the first year and one-half of its business existence.

The auditor requested that TAK save guest checks and purchase invoices for the months of December 1984, January 1985 and February 1985. The reason for this request was to allow the auditor to perform a mark-up audit. After reviewing the guest checks, the auditor determined that a mark-up audit could not be performed as the guest checks were unreadable and the auditor was unable to determine what items were being sold.

On February 13, 1985, Trifon Kolovinas, as the owner of TAK Diners, Inc, executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period December 1, 1981 through November 30, 1982 to December 20, 1985.

On September 5, 1985, the auditor wrote a letter to TAK's accountant requesting that the following documents for the period December 1, 1981 through February 28, 1985 be provided: food, wine, liquor and beer purchases; cash register tapes and guest checks; copies of invoices for all furniture, fixtures, leasehold improvements and equipment purchases; and the names, titles, current addresses and dates of office for all officers of TAK. The auditor also requested that a copy of TAK's Federal income tax return for the fiscal year ended September 30, 1984 be provided. The accountant provided the names of the officers of TAK and the Federal income tax return for the fiscal year ended September 30, 1984. Except for the purchase invoices and guest checks described above, no other books or records for the period under audit were provided.

On August 11, 1983, a flood occurred in the basement of TAK. The business's office as well as its books and records were maintained in the basement. As a result of the flood, TAK's books and records for the period December 1, 1981 through August 11, 1983 were destroyed and

therefore unavailable for review on audit. The daily summary sheets and Federal income tax returns reviewed by the auditor were available because they had been filed in the accountant's office. No explanation was provided as to the inability of TAK to produce complete purchase invoices, cash register tapes or guest checks for the period August 12, 1983 through May 31, 1985.

Given the presentation of the limited records described above, the underreporting of gross sales on the sales tax returns and the lack of source documentation which would detail the sales activities and the amount of sales tax collected, the auditor concluded that TAK 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 observed the premises between the hours of 6:00 A.M. and 10:00 P.M. on Tuesday, October 29, 1985 and then reviewed the guest checks issued between the hours of 10:00 P.M. and 6:00 A.M., October 30, 1985.

The auditor observed the business premises between the hours of 6:00 A.M. and 6:00 P.M. at which time he was relieved by another auditor. The second auditor observed the premises until 10:00 P.M. Between the hours of 10:00 P.M. and 6:00 A.M. the next day, TAK saved the guest checks for use in the audit. As a result of the observation and the guest checks, the auditor determined that TAK had taxable sales of \$1,700.00 for the 24-hour period. The auditor then reviewed Tuesday sales on the daily summary sheets for the quarters ended August 31, 1984 and May 31, 1985 and compared them to the weekly sales. As a result of such comparison, it was determined that sales on Tuesday represented 9.1 percent of sales of the week. Using the \$1,700.00 sales figure, the auditor projected weekly sales to be \$18,681.32. The auditor then multiplied the weekly sales of \$18,681.32 by 13 to arrive at quarterly sales of \$242,857.16. The quarterly sales were then compared by the auditor to TAK's average taxable sales reported for the period June 1, 1984 through May 31, 1985, the last year of the audit period. This comparison revealed an error rate of 85.5655% which when applied to taxable sales reported for the audit period resulted in additional taxable sales of \$1,482,413.00 and additional tax due of \$122,299.08.

The auditor reviewed the guest checks for December 29 and 30, 1984 in order to conduct a test of the accuracy of TAK's sales tax collections. An error rate of 2.846 percent was arrived at and applied to the audited tax due of \$264,576.27. This resulted in additional sales tax due of \$7,529.83, which represented the amount of sales tax over collected during the audit period.

In reviewing the Federal income tax returns and depreciation schedules, the auditor determined that TAK had made purchases of fixed assets and leasehold improvements totaling \$66,234.03. As no purchase invoices were provided to substantiate that sales tax had been paid on such purchases, the auditor computed tax due in the amount of \$5,464.30.

The total amount of tax determined to be due from TAK for the audit period was \$135,293.21. In turn, the notices of determination described above were issued to petitioners. The auditor recommended that penalty be assessed based upon the lack of records, the underreporting of gross sales on the sales tax returns and the comparison of reported taxable sales by TAK (\$127,101.13 per quarter) versus taxable sales determined upon audit (\$225,928.67 per quarter).

At the hearing, petitioners submitted an invoice which indicated that sales tax had been paid on the purchases of a food caddy for \$750.00 and a microwave oven for \$1,595.00. The Division of Taxation conceded that the fixed asset purchases subject to tax be reduced by the cost of these two purchases. In addition, documentation submitted at hearing established that TAK offered dinner specials on each night of the week during the years 1984 and 1985.

TAK was incorporated in November 1981 with 100 shares of common stock outstanding. The shares of its stock were distributed as follows: Trifon Kolovinas, as treasurer, owned 50 shares; Nicholas Sarantopoulos, as secretary, owned 25 shares; George Sarantopoulos, as vice-president, owned 15 shares; and Ismini Sarantopoulos, as president, owned 10 shares. George and Ismini Sarantopoulos are the parents of Nicholas Sarantopoulos. The corporation was formed for the purpose of owning and operating the business premises in issue. On December 22, 1981, TAK purchased the diner from Vega Capital Corporation for cash of approximately \$35,000.00 plus the assumption of certain indebtedness owed to Vega Capital

Corporation by a previous owner on whom Vega had foreclosed. The cash proceeds were provided by Trifon Kolovinas. The purchase agreement, dated December 22, 1981, was signed by Ismini Sarantopoulos, as president, and Nicholas Sarantopoulos, as secretary. The diner opened for business in February 1982. Almost immediately, disagreements arose between the owners.

During the period December 1981 through August 6, 1982, Trifon Kolovinas had the authority to sign corporate tax returns, to hire and fire employees, to sign corporate checks and to manage the financial affairs of the corporation. In general, due to Mr. Kolovinas' lack of knowledge of the restaurant business and Nicholas Sarantopoulos' previous experience, the management of the business and financial affairs of the corporation were handled by Nicholas Sarantopoulos. During this period of time, Nicholas Sarantopoulos signed the Certificate of Sales Tax Registration Form, signed the sales tax returns for the quarters ended February 28, 1982 and May 31, 1982, had check-signing authority for the corporation's bank accounts, signed the check for the sales tax due for the quarter ended February 28, 1982, worked with the accountant in preparing the sales tax returns, hired employees, managed the business operation, purchased supplies, operated the cash register and received a salary as manager of the diner.

The continued failure of the diner to be profitable increased the tensions between the owners. As a result of the constant acrimony, Nicholas Sarantopoulos resigned as an officer and director of TAK on August 7, 1982. On September 1, 1982, Trifon Kolovinas purchased Nicholas Sarantopoulos' 25 shares of TAK stock.

During the period August 7, 1982 through April 10, 1983, Trifon Kolovinas continued to have the authorities outlined above. Due to the resignation of Nicholas Sarantopoulos as an officer and director and Trifon Kolovinas' purchase of his shares of stock, Mr. Kolovinas exercised exclusive authority over the management of the business and its financial affairs. He signed the sales tax returns for the quarters ended August 31, 1982, November 30, 1983 and February 28, 1983. In addition, he signed, on December 13, 1982, as president, an Application for 3-Month Extension for Filing a Franchise Tax Report and, on January 28, 1983, as president,

the New York State and City of New York Employer's Return of Tax Withheld, Form IT-2101. During this period of time, Mr. Kolovinas had sole control over the books and checking accounts of the corporation, the hiring and firing of employees and the operation of the cash register. In addition, he assisted in the preparation of the tax returns and decided which creditors to pay. Nicholas Sarantopoulos continued to receive a salary as the manager of TAK, but he had no decision-making authority with regard to the financial affairs or operations of the corporation. Ismini Sarantopoulos signed, on January 8, 1983, as president, the Reconciliation of Tax Withheld for the year 1982, Form IT-2103, at the direction of Mr. Kolovinas. On April 11, 1983, Trifon Kolovinas and Nicholas Sarantopoulos entered into an agreement which provided that Mr. Kolovinas sell his 75 shares of stock in TAK to Nicholas Sarantopoulos for \$115,000.00 and resign as an officer and director of TAK. In addition, the agreement provided that Mr. Kolovinas had the option to repurchase the shares of stock on or before September 15, 1983. On April 11, 1983, Nicholas Sarantopoulos again became an officer, director and shareholder of TAK.

During the period April 11, 1983 through September 14, 1983, Trifon Kolovinas had minimal contact with the business premises. He had no responsibility or authority with regard to TAK's management or its financial affairs. Nicholas Sarantopoulos had and exercised full managerial and financial control over the affairs of the corporation. During this period, he signed the sales tax return for the quarter ended August 31, 1983, the New York State and City of New York Employer's Returns of Tax Withheld for the months of January, February and August 1983, and the New York State Corporation Franchise Tax Report for the period February 1, 1982 through September 30, 1982. Nicholas Sarantopoulos directed his mother, Ismini Sarantopoulos, to sign the withholding tax return for the month of March 1983 and the sales tax return for the quarter ended May 31, 1983. In an effort to stop the closing of the diner and to satisfy various tax warrants filed against TAK, Nicholas Sarantopoulos entered into payment agreements on behalf of the corporation with the Tax Compliance Division of the Department of Taxation and Finance. On September 15, 1983, Trifon Kolovinas exercised his option and repurchased the 75 shares of stock sold to Nicholas Sarantopoulos. Nicholas Sarantopoulos resigned as an officer and

director of TAK and had no further involvement in the operation of the diner during the remaining portion of the audit period. Mr. Kolovinas again became an officer, director and shareholder of TAK.

During the period September 15, 1983 through May 31, 1985, Mr. Kolovinas had and exercised the authority to sign corporate tax returns, to hire and fire employees, to sign corporate checks and to manage the financial affairs of the corporation. It was during this period of time, on February 13, 1985, that he signed the consent extending the period of limitations described above.

During the years at issue, Ismini and George Sarantopoulos had minimal duties and responsibilities with regard to the operation of the corporation. They had no authority to hire or fire employees or to negotiate contracts. Ismini Sarantopoulos signed tax returns only at the request and direction of Mr. Kolovinas or her son, but did not participate in their preparation. George Sarantopoulos made local purchases of supplies when requested to do so by his son. They never signed checks or other corporate documents. They did not have the authority to direct the operation of the business or to decide which creditors to pay, and their knowledge of the financial affairs of the corporation generally came from their son.

OPINION

In the determination below, the Administrative Law Judge held that the audit procedures used by the Division of Taxation properly determined the amount of sales tax due from TAK. The Administrative Law Judge further found that petitioner Nicholas Sarantopoulos was a responsible person under a duty to collect sales and use tax for TAK, and as such was personally liable for tax and penalty for the period April 11, 1983 through September 15, 1983, but was not liable for the remaining periods of the assessment.

On exception, petitioner argues that the one-day observation test was arbitrary, capricious and unreasonable, and that at the very least, the Division should have been required to use a longer test period. Petitioner asserts that the day chosen by the Division to observe petitioner's business does not reflect the typical business of the diner. Petitioner further argues that the

Division seeks to hold personally responsible a corporate officer who left the business years before the audit was conducted and who was given no notice that an audit was being conducted, thus depriving petitioner of any opportunity to establish at the time the audit was conducted, that TAK had filed correct sales tax returns and paid the proper amount of sales taxes for the period in question during which petitioner was involved and had maintained books and records. Therefore, petitioner argues that the Notice of Determination issued to petitioner should be completely annulled, including the period April 11, 1983 through September 15, 1983.

The Division argues that petitioner has failed to sustain his burden of proof to establish by clear and convincing evidence that the audit method employed was unreasonable or incorrect. Therefore, the Division requests that we sustain the determination of the Administrative Law Judge.

We affirm the determination of the Administrative Law Judge.

As a vendor of food and beverages, TAK was responsible for collecting sales tax on its retail sales (Tax Law §§ 1105[d][i] and 1132[a]). TAK was 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][1]) 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]).

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 states 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 its 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" (Matter of 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, Inc. v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Rest. v. Chu, 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, lv denied 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (Matter of Giordano v. State Tax Commn., 145 AD2d 726, 535 NYS2d 255, 256-57; Matter of Urban Liquors v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138, 139; Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44 NY2d 645, 406 NYS2d 1025; 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" (Matter of Chartair, Inc. v. State Tax Commn., supra, 411 NYS2d 41, 43), "from which the exact amount of tax can be determined" (Matter of Mohawk Airlines 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 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 Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869, 2 L Ed 2d 75; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454).

In the matter at hand, petitioner does not challenge the Division's right to resort to an indirect audit method and in fact argues that the Division should have at least been required to use a longer test period.

Petitioner alleges that the one-day observation test was arbitrary, capricious and unreasonable and relies on the statement in Matter of Yonkers Plumbing & Heating Supply Corp. v. Tully (62 AD2d 18, 403 NYS2d 792, 794) that a one-month test period "was not sufficient as a reasonable and fair sample to base a 58 month projection where a difference in one or two disallowed sales could have a large effect on the accuracy of the projection."

Petitioner's argument completely disregards the much more recent court decisions in Matter of Club Marakesh v. Tax Commn. of State of New York (151 AD2d 908, 542 NYS2d 881, lv denied 74 NY2d 616, 550 NYS2d 276) and Matter of Meskouris Bros. v. Chu (139 AD2d 813, 526 NYS2d 679). Observation audits of one and two days were sustained in those decisions, notwithstanding the petitioners' arguments that the short test periods were unreasonable. The court in Matter of Club Marakesh stated that, "the fact that a longer test period might have given a better picture of petitioner's business and thus its tax liability does not satisfy petitioner's burden of proof" (Matter of Club Marakesh v. Tax Commn. of State of New York, supra, 542 NYS2d 881, 884). The principle stated in Matter of Meskouris Bros. is that where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to 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 Bros. v. Chu, supra). Applying these principles to petitioner, we conclude that petitioner's assertions that the day that sales were observed was not reflective of TAK's business does not satisfy his burden to establish by clear and convincing evidence that the audit method was erroneous (Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

Finally, we see no merit to petitioner's contention that he was harmed by the Division's failure to involve him in the audit. The facts indicate that the records of TAK were destroyed on August 11, 1983. Further, petitioner did not establish at the hearing that the diner maintained complete records during the subsequent period, including the remaining period of his

management (August 12, 1983 through September 15, 1983). In short, petitioner has not established what his participation would have added to the audit process.

Accordingly, the audit procedures and the results thereof are sustained for the period under audit (see, Matter of Meskouris Bros. v. Chu, supra; Matter of Vendra, Tax Appeals Tribunal, February 9, 1989), and more specifically, as it relates to petitioner Nicholas Sarantopoulos as a responsible officer for the period April 11, 1983 through September 15, 1983.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of petitioner Nicholas Sarantopoulos, Officer of TAK Diners, Inc., is denied;
2. The determination of the Administrative Law Judge is affirmed;²
3. The petition of Nicholas Sarantopoulos, Officer of TAK Diners, Inc., is granted to the extent indicated in finding of fact "12" and conclusions of law "E", "H", "J" and "L" of the Administrative Law Judge's determination but is otherwise denied; and

²The determination of the Administrative Law Judge cancelled the notices of determination issued to George and Ismini Sarantopoulos and as indicated above this aspect of the Administrative Law Judge's determination was not raised on exception.

4. The Division of Taxation is directed to modify the Notice of Determination dated December 18, 1985 issued to Nicholas Sarantopoulos in accordance with paragraph "3" above but such notice is otherwise sustained.

DATED: Troy, New York
February 28, 1991

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

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

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