

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
24 HOUR GROCERY & CANDY, INC. :
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, 1983 through November 30, 1986 :

In the Matter of the Petition :
of :
MOHAMED HAGAZI :
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, 1984 through November 30, 1986 :

DECISION

In the Matter of the Petition :
of :
MOHAMED NASER :
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, 1984 through November 30, 1986 :

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on August 23, 1990 with respect to the petitions of the following:

Petitioner 24 Hour Grocery & Candy, Inc., c/o Melvin L. Greenwald, 401 Broadway, New York, New York 10013, 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, 1983 through November 30, 1986 (File No. 806328);

Petitioner Mohamed Hagazi, 1689 66th Street, Brooklyn, New York 11214, 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, 1984 through November 30, 1986 (File No. 806326); and

Petitioner Mohamed Naser, 1689 66th Street, Brooklyn, New York 11214, 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, 1984 through November 30, 1986 (File No. 806327).

Petitioners appeared by Melvin L. Greenwald, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Angelo Scopellito, Esq., of counsel).

Neither the Division of Taxation nor petitioners filed briefs. The Division of Taxation's request for oral argument was denied.

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

ISSUES

I. Whether the corporation had adequate books and records so that an audit could be conducted without resort to external indices.

II. Whether petitioners established that the audit methodology was erroneous or unreasonable.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "2(c)" and finding of fact "7(b)" which have been modified. We have also made an additional finding of fact. The Administrative Law Judge's findings of fact, the modified findings of fact and the additional finding of fact are set forth below.

Petitioner 24 Hour Grocery & Candy, Inc. ("the corporation") operated a retail grocery store at 5511 5th Avenue, Brooklyn, New York. It sold food, newspapers and Lotto tickets, all of which are not taxable, and beer, soft drinks, candy and cigarettes, all of which are taxable items.

Petitioner Mohamed Hagazi was president of the corporation. Petitioner Mohamed Naser was its secretary. Mr. Hagazi and Mr. Naser do not contest that they are responsible for the payment of the corporation's sales tax.

The business had been purchased in December 1983. A notice of bulk purchase was filed with the Division of Taxation reporting the price of furniture and fixtures as \$1,000.00.

For the period under audit, the corporation reported gross sales of \$103,917.00 and taxable sales of \$42,008.00.

The corporation had a cash register but it did not use tapes in the register. There is no evidence that it gave sales invoices to its customers.

The corporation kept a listing of its daily sales. This was characterized without contradiction as a "day book".

We modify finding of fact "2(c)" to read as follows:

The records made available for the audit period were Federal income tax returns and related workpapers, New York State sales tax returns, a depreciation schedule from the Federal income tax returns, a sales journal, cash receipts journal, purchase journal, check disbursements journal, and purchase invoices for January 1986 and July 1986.¹

Subsequently, additional invoices were produced for the auditor on January 29, 1987 at Mr. Hagazi's home for 1985 and 1986 but not for 1984. Also on January 29, 1987, Mr. Hagazi exhibited daily listings of his sales which were prepared by Mr. Hagazi and Mr. Naser and given to their accountant. The sales listing was not accepted by the auditor for the reason that the figures were not supported in his opinion by sales invoices, cash register tapes or any other record for the whole audit period.

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The Administrative Law Judge's finding of fact "2(c)" read as follows:

"Records produced by the corporation for the auditor included a sales journal, cash receipts journal, as well as a purchases journal and some purchase invoices."

We modify this finding of fact to more accurately reflect the record.

The Federal corporation income tax returns of the corporation showed gross receipts (line 1c) of \$137,651.00 for 1984, \$243,441.00 for 1985 and \$140,977.00 for 1986. (These total \$522,069.00.)

Each return also showed depreciable assets of \$28,950.00 and a cost basis for depreciation of the same amount.

The auditor computed the gross sales for the 12 quarters under audit from the 1984 Federal income tax return and from the cash receipts journal. These gross sales came to \$515,080.00.

The auditor calculated that taxable sales would be 40 percent of gross sales on the basis, as he testified, of the information from the "Robert Morris survey" that "gross sales of a grocery store in Brooklyn is 40 percent taxable."

The tax due was computed as follows: The gross sales were \$515,080.00 and taxable sales were 40 percent of gross sales, resulting in taxable sales of \$206,032.00. Petitioners reported taxable sales of \$42,008.00 and were assessed the difference of \$164,024.00. Purchases of fixed assets of \$28,950.00 were also found to be taxable. The total tax due on these amounts was \$18,607.42, which was reduced by the tax that was paid with the returns of \$3,465.13, leaving a balance due of \$15,142.29.

The following notices of determination and demand for payment of sales and use taxes due were issued against 24 Hour Grocery & Candy, Inc.:

(a) on March 20, 1987 for the quarter ending February 29, 1984 for total tax due of \$2,679.27, plus penalty of \$803.79 under Tax Law § 1145 and interest of \$2,194.62, for a total amount due of \$5,677.63;

(b) on June 12, 1987 for the quarter ending May 31, 1984 for total tax due of \$1,063.64, plus penalty of \$265.91 under Tax Law § 1145 and interest of \$456.80, for a total amount due of \$1,786.35;

(c) on September 11, 1987 for the period beginning June 1, 1984 and ending November 30, 1986 for total tax due of \$11,399.38, plus penalty of \$2,836.19 under Tax Law § 1145 and interest of \$2,948.76, for a total amount due of \$17,189.33;

(d) on September 11, 1987 for the period beginning June 1, 1985 and ending November 3, 1986 for a penalty of \$565.33 under Tax Law § 1145(a)(1)(vi).

Identical notices of determination were issued on September 11, 1987 to Mohamed Hagazi and to Mohamed Naser for the period beginning December 1, 1983 and ending November 30, 1986 for tax due of \$15,142.29, penalty of \$3,771.92 under Tax Law § 1145 and interest of \$4,839.85, for a total amount due of \$23,754.06. The notices stated that the liability was asserted under Tax Law §§ 1131(1) and 1133 for the taxes due from 24 Hour Grocery & Candy, Inc. The determination for the first two quarters has been withdrawn by the Division of Taxation since those quarters were beyond the period of limitations. As reduced, the total tax due is \$11,399.38 plus penalty and interest.

We modify finding of fact "7(b)" to read as follows:

On the same date and for the period June 1, 1985 through November 30, 1986, a notice of determination was issued to Mohamed Hagazi, and to Mohamed Naser, for a penalty of \$565.33 under Tax Law § 1145(a)(1)(vi).²

We find an additional finding of fact as follows:

The corporation requested a conciliation conference with respect to the Notice of Determination and Demand issued on March 20, 1987. The request, which was dismissed as untimely, read as follows:

"The Tax Law requires that a request be filed within 90 days from the date of the statutory notice. Since the notice was issued on March 20, 1987, but the request was not mailed until August 25, 1987, or in excess of 90 days, the request is late filed."³

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The Administrative Law Judge's finding of fact "7(b)" read as follows:

"On the same date and for the period June 1, 1985 through November 30, 1986, a notice of determination was issued to Mohamed Hagazi for a penalty of \$565.33 under Tax Law § 1145(a)(1)(vi). Although not shown at the hearing but acquiesced to by petitioners, an identical notice was issued to Mohamed Naser."

We modify this finding of fact to accurately reflect the record.

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We add this additional fact to more accurately reflect the record.

OPINION

In his determination below, the Administrative Law Judge concluded that the corporation's books and records were adequate since such books and records were kept in accordance with the Commissioner's regulations. The Administrative Law Judge concluded that even though the Division of Taxation (hereinafter the "Division") referred to the corporation's "day book" as self-serving, the Division failed to challenge that the corporation's daily record of taxable sales was characterized as a day book. Secondly, the Administrative Law Judge determined that the audit was fundamentally erroneous. The Administrative Law Judge reasoned that because the Division failed to introduce the Robert Morris Survey into evidence, there was no way to judge the accuracy of the percentage figure used by the auditor in his calculations.

On exception, the Division argues that it was empowered to estimate taxable sales because the corporation's books and records were inadequate. Further, the Division contends that the auditor testified at hearing concerning the Robert Morris Survey and he fully described the audit methodology employed for determining taxable sales due for the audit period in issue. Therefore, the Division requests that we either reverse and/or modify the determination of the Administrative Law Judge. Moreover, the Division requests, if the record herein is not clear as to the percentage figure utilized from the Robert Morris Survey, that this case be remanded for further hearing to determine the basis of the percentage figure.

We reverse the determination of the Administrative Law Judge for the reasons set forth below.

Before addressing the merits of this case, it is necessary to discuss whether the corporation's petition, covering the period December 1, 1983 to February 29, 1984, was timely filed so that we have jurisdiction to reach the merits with

respect to this notice. The Administrative Law Judge failed to address this issue.

The corporation received a Notice of Determination and Demand For Payment of Sales and Use Taxes Due which was dated March 20, 1987. The corporation filed a request for a conciliation conference which was dated August 24, 1987. Such request was dismissed as untimely since it was not filed within the 90 days from which the Notice of Determination and Demand was issued. The Administrative Law Judge below reached the merits concerning the Notice of Determination and Demand which covered the period December 1, 1983 to February 29, 1984.

It is clear that the corporation received the Notice of Determination and Demand since such notice was attached to its petition. Although the date on the notice is March 20, 1987, there is no evidence of when the notice was mailed. We have recently held that where the Division has failed to prove when it mailed the notices, but has been able to prove, by the taxpayer's receipt of the notices, that they were in fact mailed, the appropriate remedy is to deem the petition timely filed (Novar TV & Air Conditioning Sales and Service, Tax Appeals Tribunal, May 23, 1991; *cf.*, Matter of Scharff, Tax Appeals Tribunal, October 4, 1990; Matter of Malpica, Tax Appeals Tribunal, June 30, 1987 [where the Division failed to prove both the fact and the date of the mailing of the notice of deficiency]). Therefore, we deem the corporation's petition with respect to the period December 1, 1983 to February 29, 1984 as timely filed.

We now address the merits of this case. The first issue presented is whether the corporation maintained adequate books and records from which an audit could have been conducted.

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 Liqs. 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., 65 AD2d 44, 411 NYS2d 41, 43; Matter of Christ Cella, Inc. v. State Tax Commn., supra), "from which the exact amount of tax can be determined" (Matter of Mohawk Airlines v. Tully, 75 AD2d 249, 429 NYS2d 759, 760).

From the record below, it is clear that the auditor requested all books and records from petitioners for the audit period (see Exhibit J). Therefore, we must determine whether the records submitted by petitioners were inadequate or insufficient to verify taxable sales receipts or to conduct a complete audit.

The corporation's books and records consisted of Federal income tax returns and related workpapers, New York State sales tax returns, a sales journal ("day book"), cash receipts journal, purchase journal, check disbursements journal, and purchase invoices only for the months of January and July, 1986. 20 NYCRR 533.2(b)(1) and (2) set forth the sales records that are required to be maintained pursuant to section 1135 of the Tax Law:

"(1) Every person required to collect tax, including every person purchasing or selling tangible personal property for resale must keep

records of every sale . . . and all amounts paid . . . and of the tax payable thereon. The records must contain a true copy of each:

"(i) sales slip, invoice, receipt, contract, statement or other memorandum of sale;

"(ii) guest check, hotel guest check, receipt from admissions such as ticket stubs, receipt from dues; and

"(iii) cash register tape and any other original sales document.

Where no written document is given to the customer, the seller shall keep a daily record of all cash and credit sales in a day book or a similar book.

"(2) The sales record either must provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected thereon or may be substantiated by analysis of supporting records" (20 NYCRR 533.2[b][1] and [2]).

In his determination below, the Administrative Law Judge concluded that because the corporation maintained a "day book," and because the Division did not attack the characterization of the corporation's "day book" or deny that it was a "day book," the "day book" in question was a sufficient record from which to conduct an audit pursuant to the regulations. We disagree.

Although 20 NYCRR 533.2(b)(1) provides that a "seller shall keep a daily record of all cash . . . sales in a day book," subdivision (2) of the same regulation section makes it clear that the day book "must provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected thereon" or otherwise "may be substantiated by analysis of supporting records" (20 NYCRR 533.2[b][2]). The "day book" produced by petitioners contained nothing more than a list of taxable sales written down by petitioners. Furthermore, petitioners did not produce any sales invoices, cash register tapes or any other record to support the list of taxable sales that were transcribed in this "day book." Clearly, such a list is insufficient to independently determine taxable sales and to conduct an audit (see, Matter of Club Marakesh v. Tax Commn. of the State of New York, 151 AD2d 908, 542 NYS2d 881, lv denied 74 NY2d 616, 550 NYS2d 276 [where the petitioner's sales receipt journal, which contained a recordation of gross sales, was deemed inadequate since the cash register and adding machine tapes and the guest checks, from which the figures in the journal

were derived, were not available for verification of the journal's figures]). Therefore, we conclude that, absent documents to independently verify the taxable sales figures in their "day book", the corporation did not have adequate books and records from which an audit could be conducted.

Where the Division properly requests and examines a taxpayer's books and records, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (Matter of Urban Liqs. 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). The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of tax assessed was erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679, 681; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451, 453).

In this case, the Division utilized an industry index, the Robert Morris Survey, to estimate petitioners' tax liability. The Administrative Law Judge below determined that the audit was unreasonable based upon the Division's failure to introduce the Robert Morris Survey into evidence at the hearing. On exception, the Division emphasizes the fact that the auditor testified at hearing that he used the Robert Morris Survey to determine the 40% figure used in calculating the corporation's taxable sales. Furthermore, the Division refers us to Exhibit J, the Field Audit Report, in which the auditor wrote that he was utilizing the Robert Morris Survey in his calculations in this audit.

We have previously held that the record must contain information identifying the external index used by the Division to establish a rational basis for the audit methodology employed (Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991; *see also*, Matter of Fashana, Tax Appeals Tribunal, September 21, 1989). Such information is necessary in order to provide petitioners with an opportunity to meet their burden of proving such methodology unreasonable

(Matter of Basileo, Tax Appeals Tribunal, May 9, 1991; Matter of Fokos Lounge, *supra*).

The external index used by the auditor in this case was the Robert Morris Survey. However, the Division failed to introduce this survey into evidence at the hearing. Therefore, the record only contains the auditor's testimony, that he used the survey to determine that 40% of sales made by a grocery store located in Brooklyn were taxable sales, and a similar statement which appears in the auditor's Field Audit Report, as evidence that the survey was utilized by the auditor and that such percentage figure was appropriate. However, petitioners never challenged the basis of the 40% figure. Since petitioners never attempted to challenge the basis of the percentage used, we conclude for the reasons that follow that the Division was not required to introduce a copy of the survey or to further describe it.

The situation herein can be compared to the situation presented in Matter of Pizza Works (Tax Appeals Tribunal, March 21, 1991). In Pizza Works, the petitioner disagreed with the validity of a 15% waste factor used by the auditor in its markup audit of petitioner. The auditor testified therein that the 15% waste factor was based on the experience of his office which allowed a 10 to 15 percent waste factor to cover all sources of waste in a pizza parlor. The petitioner did not attempt to show that the office experience relied on by the auditor was not comparable to the petitioner's business. Instead, the petitioner testified as to its own test which estimated waste at 39%. In that case, we concluded that petitioner's evidence was not sufficient to establish by clear and convincing evidence that the amount assessed by the Division was erroneous (Matter of Pizza Works, *supra*). The case presently before us commands the same result.

Petitioner herein never challenged the basis of the percentage figure that was used by the auditor in this case (*cf.*, Matter of Fashana, *supra* [where the taxpayer attempted to challenge the derivation of the percentages in this industry index]). Instead, petitioners contended that the auditor should have continued his request and search for the corporation's books and records until the auditor compiled enough information so that resort to external indices would not be necessary (Tr., pp. 73, 76-9). Therefore, petitioners have failed to sustain their burden to

establish by clear and convincing evidence that the amount assessed was erroneous (cf., Matter of Basileo, supra [where the Division's inability to respond to questions concerning two restaurants used in a comparison test by the auditor resulted in a conclusion that the audit methodology was unreasonable]; Matter of Shop Rite Wines & Ligs., Tax Appeals Tribunal, February 22, 1991 [where the Division's inability to describe the basis of a 2% figure for theft and breakage resulted in a conclusion that such percentage was unreasonable]). Therefore, we are constrained to sustain the audit and the assessments made by the Division.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is granted;
2. The determination of the Administrative Law Judge is reversed;
3. The petitions of 24 Hour Grocery & Candy, Inc., Mohamed Hagazi, and Mohamed Naser are denied; and

4. The notices of determination issued March 20, 1987, June 12, 1987 and September 11, 1987 are sustained.

DATED: Troy, New York

June 27, 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