STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
BITABLE ON BROADWAY, INC.	:	DECISION DTA No. 806708
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 February 28, 1987	:	
	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on December 20, 1990 with respect to the petition of Bitable on Broadway, Inc., 647 Broadway, New York, New York 10012 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 February 28, 1987. Petitioner appeared by Gerald B. Tepper, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Peter J. Martinelli, Esq. and Patricia L. Brumbaugh, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in response. Oral argument, at the Division of Taxation's request, was heard on June 27, 1991. Petitioner filed written comments after reviewing the transcript, in lieu of appearing at oral argument. The Division of Taxation filed a letter in response.

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

ISSUES

I. Whether the request for a conciliation conference with respect to notices S881028078M and S881028080M was properly denied as untimely.

II. Whether petitioner established that the audit methodology utilized by the Division of Taxation was unreasonable.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "1," "3," "4" and "9" which have been modified. The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

We modify finding of fact "1" to read as follows:

> Pursuant to a field audit of Bitable on Broadway, Inc. ("petitioner") which commenced in February 1987, the Division of Taxation (hereinafter the "Division") mailed a Notice of Determination and Demand for Payment of Sales and Use Taxes Due (Notice No. S880620108M), dated June 20, 1988, to petitioner in the amount of $19,476.32, plus penalty and interest, for a total amount due of $31,368.01 for the period March 1, 1984 through February 28, 1987.
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> The Division mailed two additional Notices of Determination and Demands for Payment of Sales and Use Taxes Due to petitioner dated October 28, 1988. One such notice of determination (Notice No. S881028078M) was an additional assessment for the first and last quarters of the period at issue (periods ending May 31, 1984 and February 28, 1987) in the amount of $4,044.92, plus penalty and interest, for a total amount due of $6,693.67. The other notice of determination (Notice No. S881028080M) assessed omnibus penalty pursuant to Tax Law § 1145 for the period December 1, 1986 through February 28, 1987 in the amount of $468.06.[1]

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[1] The Administrative Law Judge's finding of fact "1" read as follows:

> "Pursuant to a field audit of Bitable on Broadway, Inc. ('Petitioner') which commenced in February 1987, the Division of Taxation, on June 20, 1988, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due (Notice No. S880620108M) to petitioner in the amount of $19,476.32, plus penalty and interest, for a total amount due of $31,368.01 for the period March 1, 1984 through February 28, 1987.
>
> "On October 28, 1988, the Division issued two additional notices of determination and demands for payment of sales and use taxes due to petitioner. One such notice of determination (Notice No. S881028078M) was an additional assessment for the first and last quarters of the period at issue (periods ending May 31, 1984 and February 28, 1987) in the amount of $4,044.92, plus penalty and interest, for a total amount due of $6,693.67. The other notice of determination (Notice No. S881028080M) assessed omnibus penalty pursuant to Tax Law § 1145 for the period December 1, 1986 through February 28, 1987 in the amount of $468.06."

We modified this finding of fact because there is no evidence in the record indicating that the additional notices were in fact issued on October 28, 1988.

Previously, petitioner, by its representative, Gerald B. Tepper, C.P.A., executed consents extending the period of limitation for assessment of sales and use taxes as follows:

Date Executed	Period Extended	Date for Assessment
7-2-87	3-1-84 through 5-31-84	9-20-87
9-3-87	3-1-84 through 8-31-84	12-20-87
12-16-87	3-1-84 through 11-30-84	3-20-88
3-18-88	3-1-84 through 8-31-84	6-20-88

The initial consent was superfluous since no return was filed for that quarter. While the period of limitation for assessment of the sales tax quarter September 1, 1984 through November 30, 1984 was not extended beyond March 20, 1988 (the last consent does not include such quarter), such affirmative defense was not raised by petitioner and will not, therefore, be addressed herein.

We modify finding of fact "3" to read as follows:

> On March 10, 1989, a Conciliation Order (CMS No. 88558) was issued by the Bureau of Conciliation and Mediation Services ("BCMS") which sustained the notice of determination mailed to petitioner which was dated June 20, 1988.
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> In its petition seeking a conciliation conference with respect to the two notices of determination dated October 28, 1988, petitioner included in such petition the initial notice of determination as well as the two subsequent notices. The petition was found not to have been timely filed and a Conciliation Order (CMS No. 93970) was issued on March 24, 1989 which denied the request for a conciliation conference for all three assessments.
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> At the hearing, the Division conceded that a petition was timely filed with respect to the assessment dated June 20, 1988 (Notice No. S880620108M), but contends that the same was not true for the other assessments.[2]

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[2] The Administrative Law Judge's finding of fact "3" read as follows:

> "On March 10, 1989, a Conciliation Order (CMS No. 88558) was issued by the Bureau of Conciliation and Mediation Services ('BCMS') which sustained the notice of determination issued to petitioner on June 20, 1988.
>
> "In its petition seeking a conciliation conference with respect to the two notices of determination issued on October 28, 1988, petitioner included in such petition the initial notice of determination as well as the two subsequent notices. The petition was found not to have been timely filed and a Conciliation Order (CMS No. 93970) was issued on March 24, 1989 which denied the request for a conciliation conference for all three assessments.

We modify finding of fact "4" to read as follows:

> With respect to the notices of determination dated October 28, 1988, mailed to petitioner, the Conciliation Order (CMS No. 93970) held that the request for a conciliation conference was late filed since the request was not received until February 21, 1989, or in excess of 90 days. Petitioner presented no evidence which would contradict the findings of the Conciliation Order. It must also be noted that the Division offered no proof regarding the mailing of these notices of determination.[3]

For the periods at issue, petitioner operated a bar and restaurant business at 647 Broadway in New York City. On February 27, 1987, the auditor sent an appointment letter advising petitioner that an audit of its business would be conducted for the period March 1, 1984 through November 30, 1986. This letter requested that the following books and records be made available: journals; ledgers; sales invoices; purchase invoices; cash register tapes; exemption certificates; all sales tax records; Federal returns for 1985 and 1986; sales and purchase journals for the audit period; expense bills, nontaxable sales and purchase invoices for the months of September, October and November 1986; and all fixed asset bills. The auditor stated that when a decision was made to extend the audit period for an additional quarter (December 1, 1986 through February 28, 1987), an oral request for books and records for this quarter was made to

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> "At the hearing, the Division of Taxation conceded that a petition was timely filed with respect to the assessment issued June 20, 1988 (Notice No. S880620108M), but contends that the same was not true for the other assessments."

We modified this finding of fact because there is no evidence in the record indicating that the notices were in fact issued on October 28, 1988.

[3] The Administrative Law Judge's finding of fact "4" read as follows:

> "With respect to the notices of determination issued to petitioner on October 28, 1988, the Conciliation Order (CMS No. 93970) held that the request for a conciliation conference was late filed since the request was not received until February 21, 1989, or in excess of 90 days. Petitioner presented no evidence which would contradict the findings of the Conciliation Order. It must also be noted that the Division of Taxation offered no proof regarding the mailing of these notices of determination."

We modified this finding of fact because there is no evidence in the record indicating that the notice was in fact issued on that date.

petitioner's representative, Gerald B. Tepper, C.P.A. Mr. Tepper has not denied that such request for records was made.

With the exception of guest checks and register tapes, the auditor was provided with the records requested. The auditor maintains that Mr. Tepper informed him that guest checks and register tapes were not maintained and/or were not available for the entire audit period.

Sales and purchases per records were found to be in substantial agreement with amounts reported on Federal income tax returns. The auditor determined that petitioner's sales tax returns were estimated and, with the exception of one quarter, did not reconcile with its books and records.

The auditor examined the purchase records for the three-month period requested. In addition, confirmation letters were sent to petitioner's suppliers. Some discrepancies were discovered (the auditor found discrepancies which totalled approximately $12,500.00).

The auditor stated that he intended to perform a markup test, but was unable to do so because of large discrepancies between petitioner's purchase records and the responses from the confirmation letters. He also stated that a markup test could not be performed because selling prices could not be determined with any degree of certainty. It must be noted herein that the auditor visited the premises on two occasions (April 7 and July 1, 1987) at which times drinks were purchased (on the second visit, the auditor was accompanied by his supervisor who also purchased a drink and inquired about the price of certain other drinks) and a menu setting forth food prices was obtained. A markup test was also abandoned because petitioner's representative disputed the selling prices obtained by the auditor during his two visits to the premises.

Petitioner made available its guest checks for only one of the sales tax quarters at issue (September 1 through November 30, 1986). The auditor examined the guest checks only for a two-day period in order to determine whether or not petitioner was collecting tax at the proper rate. The auditor did not examine the remaining guest checks provided for this quarter.

Petitioner contends that the corresponding cash register tapes were also made available to the auditor for this quarter. The auditor disputes petitioner's contention, although he admits that he did not examine the guest checks made available. The auditor stated that he did not need to examine the guest checks since petitioner did not have them for the entire audit period.

Based upon the auditor's determination that petitioner did not have complete books and records for the audit period and that, under such circumstances, a complete and detailed audit could not be performed, he selected an audit method utilizing a rent factor obtained from the National Restaurant Association's Restaurant Industry Operations Report for 1987. Pursuant to this report, the rent factor for the upper quartile (the auditor was instructed to use the upper quartile by his group chief) of the northeast region was 7.1 percent. The document introduced into evidence at the hearing consisted of a title sheet along with two pages (presumably relating to restaurants with full menu table service) setting forth ratios to total sales of various income and expense factors with rent, property taxes, other taxes and property insurance constituting the category of occupation costs.

Petitioner's rental expenses were obtained from its records. These rental expenses were divided by the rent factor (7.1 percent) to arrive at adjusted taxable sales of $1,084,342.69 for the audit period. Petitioner was given credit for taxable sales reported ($848,281.00). The balance ($236,061.69) represented additional taxable sales. Additional tax due, at 8.25 percent, was found to be $19,476.32, the amount of the assessment at issue herein.

We modify finding of fact "9" to read as follows:

> As indicated above, two additional notices of determination dated October 28, 1988 were mailed to petitioner. One notice of determination (Notice No. S881028080M) assessed an omnibus penalty for the last quarter at issue. The other notice of determination (Notice No. S881028078M) assessed additional tax for the first and last quarters of the audit period. Additional tax was assessed for these quarters due to the fact that petitioner was initially given credit for tax shown to be due (and presumed by the Division to have been paid) on its returns, when, in fact, the Division's own records indicated that lesser amounts had been paid for these quarters. With respect to the last quarter, the auditor was shown an

amended return which the Division's records subsequently revealed had not been filed.[4]

OPINION

In his determination below, the Administrative Law Judge concluded that petitioner's books and records were inadequate and that the Division was authorized to use external indices to determine the amount of tax owed. However, the Administrative Law Judge concluded that the audit methodology employed by the Division was unreasonable. Therefore, he cancelled the assessment. Further, he did not address the jurisdictional issue in question since he cancelled the assessment against petitioner on the merits which he concluded rendered the jurisdictional issue moot.

On exception, the Division argues that the Administrative Law Judge erred in refusing to rule on the jurisdictional issue first, before reaching a decision on the merits. The Division asserts that such issue is fundamental to the ability of any court or administrative agency, acting in an adjudicative capacity, to impose its power upon the parties. Further, the Division contends that the Administrative Law Judge erred in his statement that:

> "In order to determine whether or not a particular [audit] method was reasonable, such method must be carefully considered in light of the particular facts presented such as the type of business under audit, records made available to the auditor, etc."

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[4] The Administrative Law Judge's finding of fact "9" read as follows:

> "As indicated in Finding of Fact '3', supra, two additional notices of determination were issued to petitioner on October 28, 1988. One notice of determination (Notice No. S881028080M) assessed omnibus penalty for the last quarter at issue. The other notice of determination (Notice No. S881028078M) assessed additional tax for the first and last quarters of the audit period. Additional tax was assessed for these quarters due to the fact that petitioner was initially given credit for tax shown to be due (and presumed by the Division to have been paid) on its returns when, in fact, the Division's own records indicated that lesser amounts had been paid for these quarters. With respect to the last quarter, the auditor was shown an amended return which the Division's records subsequently revealed had not been filed."

We modified this finding of fact because there is no evidence in the record indicating that the notices were in fact issued on October 28, 1988.

The Division argues that there is no legal basis for this proposition and that adoption of this theory shifts the burden of proof that is wholly upon petitioner to prove that the audit methodology was unreasonable or erroneous.

Lastly, the Division asserts that petitioner's mere contention that the National Restaurant Association (hereinafter "NRA") report did not take into consideration the type, size or location of a particular restaurant is not enough proof to sustain petitioner's burden to establish by clear and convincing evidence that the audit which utilized the NRA report was unreasonable. Therefore, the Division requests that the Administrative Law Judge's determination be overturned and the notices of determination be sustained in full.

In response, petitioner appears to dispute the Administrative Law Judge's conclusion that petitioner had inadequate books and records from which to conduct an audit. Furthermore, petitioner states that "it is obvious that we petitioned the Appeals Tribunal [sic] in [a] timely manner and Prima Facie established the jurisdictional rights of the Administrative [Law] Judge to rule on the issues Petitioner has brought to the court" (petitioner's brief, p. 3).

Lastly, petitioner contends that the Division's use of a rent factor to calculate an assessment is beyond belief and that a rent factor cannot be applied to determine sales unless a great many facts are known which was not the situation in the case herein. Petitioner alleges that the NRA report was a national report, not "jurisdictional," and, thus, does not apply in this situation. Therefore, petitioner requests that the determination be sustained.

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

We agree with the Division that it is a well established principle that a court must have subject matter jurisdiction before it can discuss the merits of a case (see, Robinson v. Oceanic Steam Nav. Co., Ltd., 112 NY 315). Moreover, an objection based upon subject matter jurisdiction can be made at any time (see, Tax Law § 2006.5[ii]). Therefore, we begin our analysis by focusing on the jurisdictional issue.

Where the Division has denied a taxpayer a conciliation conference on the grounds that the request was not timely, the Division is required to establish when it mailed the notices of determination (Matter of Novar TV & Air Conditioner Sales & Serv., Tax Appeals Tribunal, May 23, 1991; see also, Matter of Malpica, Tax Appeals Tribunal, July 19, 1990). The Division may prove the act of mailing by establishing its customary procedure for the mailing of such notices and by introducing evidence that such procedure was followed in this case (Matter of Novar TV & Air Conditioner Sales & Serv., supra).

The Division failed to submit any proof whatsoever to establish that notices S881028078M and S881028080M were properly mailed. 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 (Matter of Katz, Tax Appeals Tribunal, November 14, 1991; Matter of Novar TV & Air Conditioner Sales & Serv., supra). Petitioner in fact did receive the notices of determination in issue as evidenced by its petition filed with the Division of Tax Appeals which had such notices of determination attached to it. Therefore, we deem petitioner's petition timely filed and, thus, we have subject matter jurisdiction to review the merits of the case herein.

We begin by first addressing an argument made by petitioner in its brief in response to the Division's exception. Petitioner states that:

> "it is very clear that N.Y.S. Sales Tax Bureau has tried every manner of averting the proper accounting methods of auditing the books and records which has [sic] been clearly established as being complete and fully presented to them as requested" (petitioner's brief, p. 3).

In his determination below, the Administrative Law Judge concluded that petitioner did not maintain adequate books and records from which an audit could be conducted. Based upon our review of the record, we agree with the Administrative Law Judge and the reasoning set forth in his determination in concluding that petitioner failed to maintain adequate books and records. We see absolutely nothing in the record to support petitioner's claim that it maintained guest checks for the entire audit period.

We now turn to the issue of whether the audit methodology employed by the Division was unreasonable.

Where, as here, the records of the taxpayer are insufficient or inadequate to permit an exact computation of the sales and use tax due, the Division is authorized to estimate the tax liability on the basis of external indices (Tax Law § 1138[a][1]; see, Matter of Ristorante Puglia, Ltd. v. Chu, 102 AD2d 348, 478 NYS2d 91, 93; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451, 452). The methodology selected must be reasonably calculated to reflect the taxes due (Matter of Ristorante Puglia, Ltd. v. Chu, supra; Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869) but exactness in the outcome of the audit method is not required (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, 177, affd 44 NY2d 684, 405 NYS2d 454; Matter of Lefkowitz, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, supra).

The Division objects to a statement made by the Administrative Law Judge that:

> "[i]n order to determine whether or not a particular [audit] method was reasonable, such method must be carefully considered in light of the particular facts presented such as the type of business under audit, records made available to the auditor, etc."

The Division contends that adoption of this theory shifts the burden of proof to the Division. We do not interpret this statement as one which shifts the burden of proof that is upon petitioner to establish that the audit methodology employed was unreasonable.

In his determination below, the Administrative Law Judge dismissed the assessments issued against petitioner because the auditor did not understand how the information set forth in the NRA report was compiled. In conclusion of law "B", the Administrative Law Judge wrote:

> "Petitioner contends that the National Restaurant Association report does not take into consideration the type, size or location of a particular restaurant and that the Division of Taxation cannot employ this or other similar reports or surveys without fully understanding how the information

> was compiled or how such information can, if at all, be correlated to a specific business. I must agree with petitioner's contentions."

The above-quoted phrase misinterprets the law. "The Audit Division is not responsible for demonstrating the propriety of the assessment, including the basis for its audit" (Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, 538), and "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in this case" (Matter of Grecian Square v. New York State Tax Commn., 119 AD2d 948, 501 NYS2d 219, 221), and petitioner bears the burden to prove the audit methodology unreasonable (Matter of Surface Line Operators Fraternal Org. v. Tully, supra). However, the record must contain sufficient evidence to allow the trier of fact to determine whether the audit had a rational basis (Matter of Grecian Square v. New York State Tax Commn, supra, 501 NYS2d 219, 221; Matter of Fokos Lounge, Tax Appeals Tribunal, March 7, 1991; Matter of Fashana, Tax Appeals Tribunal, September 21, 1989).

The auditor at hearing testified that he utilized the NRA report. The report was clearly identified and was subject to examination by petitioner. We do not agree with the Administrative Law Judge's statement that the Division had the further obligation to understand and explain the compilation of the chart and how it specifically related to petitioner. The purpose of requiring the Division to identify the report utilized in this type of audit (see, Matter of Fokos Lounge, supra; Matter of Fashana, supra) is to provide a petitioner with access to the source of the chart and, thus, with the ability to introduce evidence challenging the soundness or applicability of the report. In other words, it ensures that a petitioner has the opportunity to sustain his burden of proof. In our view, to require that the Division explain the derivation of a report prepared by a third party would accomplish nothing except to introduce another level of questions as to whether the Division's description was accurate. We conclude that the

Administrative Law Judge erred in finding the audit methodology unreasonable based on the inability of the auditor to explain the compilation of the NRA report.[5]

On exception, petitioner disputes the use of the NRA report for a number of reasons. Petitioner asserts that the report does not take into account the different locations of restaurants, the economics of how long a restaurant's lease has been in effect, and the changes in the economy during the lease period. Further, petitioner argues that the report is not "jurisdictional," but rather, that it is national, and, therefore, the report is overly general. Lastly, petitioner contends that reports of this nature are written and compiled for larger restaurants and chains as a guide in selecting possible locations for restaurants, but such reports can never be specifically relied upon unless all other facts of the business are known. We disagree.

Tax Law § 1138(a)(1) specifically authorizes the use of rental paid as an external index to measure the sales tax liability due (see, 20 NYCRR 535.2). Furthermore, as stated above, the burden is upon petitioner to demonstrate that the audit methodology employed by the Division was erroneous (see, Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra). Petitioner's mere contentions that the report was overly general and that it did not take into account the location of the particular restaurants does not establish by clear and convincing evidence that the audit was erroneous or unreasonable. At the hearing below, the auditor testified that he utilized the NRA report. A title sheet along with two pages setting forth ratios to total sales of various income and expense factors with rent, property taxes, other taxes and property insurance constituting the category of occupation costs was introduced into evidence (cf., Matter of Fokos Lounge, Tax Appeals Tribunal, supra [where we found the rent factor audit unreasonable since the auditor testified to utilizing a Dun and Bradstreet report, yet the report introduced into evidence was not clearly identifiable as a Dun and Bradstreet

[5]We stress the difference between the instant case and those cases where the audit methodology is based on facts that are peculiarly within the knowledge of the Division, e.g., audits of similar establishments, where the Division has the obligation to describe these facts in response to the petitioner's inquiries at hearing (see, Matter of Basileo, Tax Appeals Tribunal, May 9, 1991).

report]). At no time did petitioner introduce evidence demonstrating that these figures did not apply to its restaurant by distinguishing its restaurant from the restaurants used to compile the report. Therefore, we conclude that petitioner failed to sustain its burden of demonstrating that the audit methodology was unreasonable.

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 petition of Bitable on Broadway, Inc. is denied; and

4. The notices of determination and demand for payment of sales and use taxes due issued to Bitable on Broadway, Inc., dated June 20, 1988 and October 28, 1988, are sustained.

DATED: Troy, New York
January 23, 1992

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

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

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