

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
S & K SMOKE SHOP, INC. AND	:	
HARESH KHIANI AND BARBHAJ SAVALIA, AS OFFICERS	:	DECISION
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 November 1,	:	
1983 through February 28, 1987.	:	

Petitioners S & K Smoke Shop, Inc. and Haresh Khiani and Barbhai Savalia, as officers, 120 West 34th Street, New York, New York 10001, filed an exception to the determination of the Administrative Law Judge issued on December 13, 1990 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 November 1, 1983 through February 28, 1987 (File No. 806993). Petitioners appeared by Haresh Khiani, President of S & K Smoke Shop, Inc. The Division of Taxation appeared by William F. Collins, Esq. (Angelo A. Scopellito, Esq., of counsel).

Petitioners did not file a brief on exception. The Division of Taxation filed a letter in lieu of a brief. Oral argument, requested by petitioners, was denied.

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

ISSUE

Whether two observation tests properly determined sales and use taxes due from petitioner S & K Smoke Shop, Inc.

FINDINGS OF FACT

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

Petitioner S & K Smoke Shop, Inc. ("the corporation") operates a concession stand in the Woolworth store at 120 West 34th Street, New York, New York. It sells cigarettes and other tobacco products, tobacco accessories and magazines. It also operates as a New York State Lottery vendor.

Haresh Khiani is president of the corporation and Barbhai Savalia is secretary. Each owns one-half of the issued and outstanding stock.

This matter was selected for audit on the basis of the BMF¹ audit program which compares gross receipts reported by taxpayers on their Federal income tax returns with gross sales reported on their sales tax returns. It was determined that the corporation did not report gross sales on its sales tax returns, but reported only taxable sales and tax due. A field audit of the business was commenced by the New York District Office on June 3, 1986. The audit activities and findings were as follows:

(a) The auditor determined that the corporation's records were inadequate, as no invoices or cash register tapes were produced. The corporation did not use a cash register, but instead used boxes for cash receipts and change. The cash receipts book was disregarded, since it showed receipts for five days per week, while the auditor found that the business was open seven days.

(b) An observation test was performed on Tuesday, August 26, 1986, between 10:00 A.M. and 5:45 P.M. It showed \$752.05 in total sales (excluding lottery sales) of which \$346.61 were taxable and \$405.54 were nontaxable.² This resulted in total sales of \$94.01 per hour, which figure was multiplied by the number of hours the Woolworth store was open per week (61) resulting in audited weekly gross sales of \$5,734.61.

¹Business Master File

²There would appear to be an error of \$.10 in the latter 2 figures, which are found on page 21 of the transcript of hearing. The taxable and nontaxable sales shown in the worksheets in evidence are rounded to even dollar amounts.

(c) The audited weekly gross sales were applied over the audit period of three years and four months for total gross sales of \$993,999.00. This figure was multiplied by the taxable percentage of 46% resulting in audited taxable sales of \$457,240.00. As reported taxable sales were \$72,968.00, the additional taxable sales were \$384,272.00, indicating an error percentage of 526.6%. Application of the error percentage to the additional taxable sales resulted in additional tax due of \$31,702.44.³

(d) The corporation's officers executed a series of four consents extending the period of limitation for assessment of sales and use taxes for the period September 1, 1983 through November 30, 1984 to December 20, 1987.

On December 20, 1987, the Division of Taxation issued the following notices of determination and demands for payment of sales and use taxes due:

(a) To S & K Smoke Shop, Inc.:

(i) Period November 1, 1983 through February 28, 1987, \$31,700.47 tax, \$7,981.27 penalty, plus interest.

(ii) Period June 1, 1985 through February 28, 1987, omnibus penalty \$1,688.59.

(b) To Haresh Khiani, as officer of S & K Smoke Shop, Inc.:

(i) Period November 1, 1983 through February 28, 1987, \$31,700.47 tax, \$7,981.27 penalty, plus interest.

(ii) Period June 1, 1985 through February 28, 1987, omnibus penalty \$1,688.59.

(c) To Barbhai Savalia, as officer of S & K Smoke Shop, Inc.:

(i) Period November 1, 1983 through February 28, 1987, \$31,700.47 tax, \$7,981.27 penalty, plus interest.

(ii) Period June 1, 1985 through February 28, 1987, omnibus penalty \$1,688.59.

Petitioners filed a timely request for a conciliation conference with the Bureau of Conciliation and Mediation Services. Pursuant to the conference, a second observation test was

³Note that the tax assessed (Finding of Fact "4") is \$31,700.47, due to application of the error percentage to taxable sales reported on a quarterly basis.

performed on November 1, 1988, also a Tuesday, showing total sales of \$382.00 with \$140.00 taxable and \$242.00 nontaxable. It was noted that at that time cigarettes were sold for \$1.40 per package. The results of the two observation tests were averaged for new audited daily sales of \$567.00 and a new taxable percentage of 43%. The new hourly gross of \$71.00 was multiplied by 54 hours per week (as petitioners claimed the business had been open only six days per week for most of the audit period), resulting in audited gross sales of \$664,560.00 for the audit period. After applying the revised taxable percentage of 43%, the revised audited taxable sales were determined to be \$285,761.00 and additional taxable sales \$212,793.00. The percentage of error was reduced to 291.62% and additional tax due was reduced to \$17,555.04. The omnibus penalty was reduced to \$935.10. Petitioners refused to sign a withdrawal for the reduced amounts, and filed a petition for a hearing.

The corporation acquired the business in or about November 1983. The business was open six days per week (closed on Sunday) from the inception until early 1986. Prior to 1986, the business was able to isolate its space with a gate on Sundays when the Woolworth store was open. After that time, an adjacent concessionaire was open for business on Sunday requiring the gate to be open. Accordingly, the corporation also opened for business on Sunday, even though sales were slow, in order to protect its merchandise from theft. The business hours were as follows:

10 A.M. to 5:45 P.M. on Tuesday, Wednesday and Saturday;
10 A.M. to 7:45 P.M. on Monday, Thursday and Friday;
and 11:00 A.M. to 4:45 P.M. on Sunday.

During the Christmas season, the business was open for approximately one hour later.

During 1983, petitioner sold cigarettes for approximately \$.95 per package.

At the hearing, petitioners offered a document purporting to be the corporation's cash receipts book, which listed taxable and nontaxable sales on a daily basis ranging from October 31, 1983 to February 27, 1987. This document, however, must be discounted as unreliable since it shows no Saturday or Sunday sales. According to the auditor, petitioners

claimed that weekend sales were probably included with Monday sales. However, perusal of the record shows that Monday sales were not disproportionate to sales for other days of the week.

At the request of the Administrative Law Judge, petitioners submitted the corporation's weekly lottery statements from the New York State Division of Lottery. Analysis of the statements shows that there is virtually no correlation between the weekly net lottery sales and the sales shown in the cash receipts book. Lottery sales appear to be fairly consistent over the audit period, although certain weeks were substantially higher than others, possibly reflecting activity due to an unusually high jackpot offered during such weeks.

OPINION

In the determination below, the Administrative Law Judge held that the records of S & K Smoke Shop, Inc. were clearly incomplete and insufficient and it was, therefore, proper for the Division of Taxation (hereinafter the "Division") to estimate taxes based on an observation of the business. However, the Administrative Law Judge reduced the audited sales and the taxable percentage to reflect lower prices which prevailed in the periods well before the dates of the observation tests. Lastly, the Administrative Law Judge found that petitioners failed to sustain their burden of proof to show that the audit method or the amount of tax assessed was erroneous.

On exception, petitioners assert: "sales figure for taxable and non-taxable sales is incorrectly calculated; sales cannot remain constant from the day you start business until the life of business; variations in daily sales not considered; sales included sales tax which was not considered; sales diary clearly reflects daily taxable and non-taxable sales; auditor's figure in taxable and non-taxable sales was wrong at first physical examination; and inflation factor was not considered" (Petitioners' exception).

The Division argues in response that petitioners' records were incomplete and insufficient to determine the exact tax due for the audit period, that petitioners failed to meet their burden of proving that the audit was erroneous, that the computations derived from the facts obtained from two observation tests were utilized in a rational basis and that the decision of the Administrative

Law Judge dated December 13, 1990 should be sustained for the reduced amount indicated therein.

We find no basis in the record before us for modifying the Administrative Law Judge's determination in any respect. Therefore, we affirm the determination of the Administrative Law Judge for the reasons stated in said determination.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of S & K Smoke Shop, Inc. and Haresh Khiani and Barbhai Savalia, as Officers is denied:

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of S & K Smoke Shop, Inc. and Haresh Khiani and Barbhai Savalia, as Officers is denied; and

4. The notices of determination and demand for payment of sales and use taxes due dated December 20, 1987, reduced pursuant to a Conciliation Order dated March 3, 1989, and further modified by the determination of the Administrative Law Judge dated December 13, 1990 are hereby sustained.

DATED: Troy, New York
July 18, 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