

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

JOSEPH AGNONE AND NICOLA NAPPO :
D/B/A ANTHONY'S PIZZERIA :

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, 1984 :
through November 30, 1987. :

In the Matter of the Petition :

of :

JOSEPH AGNONE AS PARTNER OF :
ANTHONY'S PIZZERIA :

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, 1984 :
through November 30, 1987. :

DECISION
DTA Nos. 807474,
807475 & 807480

In the Matter of the Petition :

of :

NICOLA NAPPO AS PARTNER OF :
ANTHONY'S PIZZERIA :

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, 1984 :
through November 30, 1987. :

Petitioners Joseph Agnone and Nicola Nappo d/b/a Anthony's Pizzeria, 721 East Jericho Turnpike, Huntington, New York 11743, Joseph Agnone as partner of Anthony's Pizzeria, 5 Treehollow Lane, Dix Hills, New York 11746 and Nicola Nappo as partner of Anthony's Pizzeria, 232 Princess Street, Hicksville, New York 11801 filed an exception to the

determination of the Administrative Law Judge issued on March 21, 1991 with respect to their petitions 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, 1984 through November 30, 1987. Petitioners appeared by Peter R. Newman, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Petitioners filed a memorandum of law in support of their exception. The Division of Taxation filed a letter brief in opposition. 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 petitioners have established that the audit methodology used by the Division of Taxation was unreasonably inaccurate or that the results of the audit were incorrect.

FINDINGS OF FACT

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

As the result of a field audit, the Division of Taxation (hereinafter the "Division") issued two notices of determination and demands for payment of sales and use taxes due, dated July 20, 1988, to petitioner Joseph Agnone & Nicola Nappo d/b/a Anthony's Pizzeria ("Anthony's"). The first notice assessed a sales tax deficiency in the amount of \$73,156.00 for the period September 1, 1984 through November 30, 1987, plus penalty and interest. The second notice, assessed an additional penalty of \$5,551.70 for the period June 1, 1985 through November 30, 1987. The Division issued separate notices of determination to petitioners Nicola Nappo and Joseph Agnone as individuals, assessing identical amounts of tax, penalty and interest for the same periods. The notices explained that as partners Mr. Nappo and Mr. Agnone were individually liable for taxes determined to be due from Anthony's Pizzeria.

Anthony's representative, acting under a valid power of attorney, executed a consent extending the period of limitation for assessment of sales and use taxes for the period September 1, 1984 through February 28, 1985 to June 20, 1988. There is no evidence of other consents having been executed by petitioners. Petitioners raised no issues with regard to the timeliness of the assessments.

Anthony's operated a neighborhood pizza parlor on Long Island. At the outset of this audit, the Division sent Anthony's an appointment letter in which it specifically requested that Anthony's make available for inspection all of its sales tax records for the period September 1, 1984 "thru present". The date of the letter was July 22, 1987. Among the records specifically requested were: sales invoices, purchase invoices, cash register tapes, journals and ledgers, and exemption certificates.

On the date of the first audit appointment, the auditor met with Mr. Nappo, Mr. Agnone and their accountant. The Division was informed that no books or records were available for any period before December 31, 1985. The accountant had reconstructed Anthony's receipts for the period January 1, 1986 through January 1987 based upon bank statements and purchase invoices given to him by Anthony's partners, but he could not, and would not, vouch for the accuracy of his computations. The accountant provided the Division with income and expense statements for periods after January 1987. Upon being informed that Anthony's did not retain cash register tapes or maintain a daily record of sales, the auditor asked petitioners to begin keeping such records for her use in performing an audit. The auditor asked to see these records several times, directing her requests to Mr. Agnone, Mr. Nappo, Anthony's accountant and Anthony's attorney. They were never presented to her.

Since verifiable records of sales were not available, the auditor attempted to collect information which would enable her to perform a test period markup audit. The audit worksheets show that the auditor had obtained some information regarding purchases from petitioners. There were purchase invoices from two suppliers for the months of April, May and July 1987, transcripts of the income and expense statements prepared by Anthony's accountant,

and purchase figures taken from Anthony's Federal income tax return. The auditor considered the ratio between sales and purchases as shown on the Federal return unrealistic. Furthermore, Anthony's own records were too scanty to allow the auditor to determine whether all purchases were reflected in the records she had available. She therefore attempted to verify Anthony's purchases by contacting suppliers. One of the suppliers contacted was identified from purchase invoices supplied by Anthony's, but this supplier refused to cooperate with the Division. The auditor also contacted businesses in the area known to sell supplies to local pizzerias. This methodology proved unsuccessful because the responses received were incomplete at best. Because it was unable to verify Anthony's purchases through contact with suppliers, and considered Anthony's own records to be unreliable, the Division decided that a markup of purchases audit would not be feasible. While still in the process of attempting to collect information from suppliers, the Division decided to perform an observation test.

The date of the observation test was September 10, 1987, a Thursday. The auditor noted in her workpapers that the weather that day was warm and sunny. Business hours were 11:00 A.M. to 9:30 P.M., and one of two auditors was on the premises during that time.

The auditors listed the items sold by Anthony's, e.g., soda, pizza slices and coffee, and then kept a count of each item sold during the day. The auditors also kept a count of the number of people who entered the pizzeria which turned out to be 268. To determine taxable sales, the auditor applied the appropriate sales prices to the items sold and totalled the results. In this manner, the auditor calculated total sales for the day of \$962.50. On the day of the observation test, Anthony's used a cash register to record sales. The cash register tape showed gross sales for the day of \$1,047.27. The auditor divided this by 1.075 to calculate taxable sales according to Anthony's records of \$974.20 per day. Based on this figure, she computed audited taxable sales per quarterly sales tax period of \$88,652.20 and audited taxable sales for the period September 1, 1984 through November 30, 1987 of \$1,152,476.00. Anthony's reported taxable sales for the same period of \$174,383.00. The auditor subtracted reported taxable sales

from audited taxable sales to calculate additional taxable sales of \$978,093.00 with a tax due on that amount of \$73,156.00. These calculations became the basis for the assessments issued.

On January 12, 1988, the auditor met with Mr. Peter R. Newman, petitioners' attorney, to discuss the audit. At that time, the auditor asked for permission to conduct a second observation test, but Mr. Newman refused to agree to this. Mr. Newman showed the auditor amended sales tax returns for the period September 1, 1984 through August 31, 1987, and the auditor transcribed some information shown on those returns. At the time that this audit was completed, she was unable to verify that these returns had been filed. At hearing she testified that the returns were filed after the close of her audit and that the tax due had been paid. Her transcript of those returns shows that the amount of sales tax paid by Anthony's with its amended filings was approximately \$7,948.45.

The auditor made notes of her meeting with Mr. Newman in the Tax Field Audit Record. These notes contain the following statement: "Requested records til 11/30/87". The notes show that the auditor had no other direct contact with Mr. Newman until after the notices of determination were issued. The Field Audit Report includes a copy of a power of attorney appointing Mr. Newman to represent Anthony's in connection with the Division's audit of sales tax for the period September 1, 1984 through August 31, 1987. The only other date on the power of attorney is the date of notarization of Mr. Agnone's signature which was September 29, 1987.

Petitioners offered no documentary evidence or testimony at the hearing. At the request of their representative, the record was left open to give petitioners an opportunity to submit evidence of seasonal fluctuations in the pizza business and inflationary trends during the audit period and also to submit a memorandum of law. The date agreed upon for petitioners' submission of documents and a memorandum of law passed without their being submitted, and the record was then closed.

OPINION

The Administrative Law Judge determined that the books and records of petitioners were inadequate for the audit period. Therefore, she held that the Division was correct in resorting to an external index to determine the sales and use taxes due. Petitioners alleged that a test period markup was a more preferable method; however, the Administrative Law Judge found that petitioners had failed to rebut the auditor's testimony regarding the infeasibility of a markup test, and further failed to show that the observation test results were unreasonable. Additionally, the Administrative Law Judge held that the use of a one day observation test was reasonable. Finally, it was determined that petitioners' failure to raise the statute of limitations at the hearing caused such defense to be waived.

On exception, petitioners assert that the use of a one day observation test to determine sales and use tax due for the three-year audit period is unreasonable. Petitioners also assert that any assessment made after the expiration of the statute of limitations is null and void.

In opposition, the Division relies upon the determination of the Administrative Law Judge.

We affirm the determination of the Administrative Law Judge.

Every person required to collect sales tax is also required to keep records of every sale (Tax Law § 1135; see also, 20 NYCRR 533.2). Failure to maintain records, or the maintenance of inadequate records, will result in the estimation of tax due based upon external indices (Tax Law § 1138[a]).

When estimating sales tax due, the Division must adopt an audit method reasonably calculated to reflect the amount of taxes due (Matter of W. T. Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (see, Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

However, unreasonable is not the same as imprecise. The fact that an estimation of sales tax due is required negates any demand for exactness on the part of the auditor (Matter of Meskouris Bros. v. Chu, supra). Accuracy was sacrificed in the first instance by the failure of the taxpayer to maintain adequate records. This initial failure cannot later inure to the taxpayer's benefit. Therefore, the audit method utilized must only be reasonable (see, Matter of W. T. Grant Co. v. Joseph, supra).

The Administrative Law Judge determined that the audit method employed by the auditor was reasonable. We agree. When a taxpayer's books and records are deemed inadequate, the use of an observation test to determine sales tax due has consistently been held to be proper (see, Matter of Vebol Edibles v. State of New York Tax Appeals Tribunal, 162 AD2d 765, 557 NYS2d 678, lv denied 77 NY2d 803, 567 NYS2d 643; Matter of Meskouris Bros. v. Chu, supra; Matter of AR & RA Foods, Tax Appeals Tribunal, May 2, 1991).

Further, petitioners' own actions prevented the auditor from conducting a more extensive analysis. Because no books or records were available, the auditor requested that petitioners begin retaining cash register tapes or a daily record of sales (see, Tr., pp. 21, 22). Despite repeated requests by the auditor to see these records, they were not made available (see, Tr., p. 22). Therefore, the auditor attempted to gather information necessary to conduct a test period markup (see, Tr., p. 23). However, petitioners' records were inadequate, and an inquiry of some of petitioners' suppliers, as well as local pizzeria suppliers in general, yielded inadequate responses (see, Tr., pp. 23-25, 39, 48; Exhibit U). Further, the auditor, though allowed to conduct one observation test, was denied the opportunity to conduct a second observation test (see, Tr., pp. 25, 37-38, 39-40).

In sum, petitioners' lack of records and lack of cooperation resulted in the auditor having to base the estimate of sales tax due upon the one day observation test (see, Tr., pp. 39, 42-43). Therefore, petitioners' complaint concerning the use of a one day observation test to determine sales tax due is unfounded.

Petitioners also assert that any assessment made after the expiration of the statute of limitations is null and void. This is incorrect. The statute of limitations defense must be affirmatively raised by the taxpayer at the hearing (see, Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109; Matter of Convissar v. State Tax Commn., 69 AD2d 929, 415 NYS2d 305; Matter of Servomation Corp. v. State Tax Commn., 60 AD2d 374, 400 NYS2d 887; Matter of Jencon, Tax Appeals Tribunal, December 20, 1990; see also, Siegel, New York Practice, § 34 at 38 [2d ed]). Failure to raise it at the hearing will cause the defense to be deemed waived (see, Matter of Convissar v. State Tax Commn., supra; Matter of Servomation Corp. v. State Tax Commn., supra; Matter of Jencon, supra). Petitioners' first discussion of the implications of the statute of limitations on the assessment appears in the exception. As this issue was not addressed in the hearing below, we must deem the defense waived.

Petitioners allege that the consent extending the period of limitation for assessment of additional tax is invalid because petitioners were unaware that no prior waiver had been effectuated. To summarize, petitioners state that the Division "concealed" relevant information; that petitioners relied on the words or conduct of the Division to petitioners' detriment; and that the Division has offered no evidence to demonstrate petitioners' intent to relinquish its protection under the statute of limitations.

Petitioners misinterpret the Administrative Law Judge's discussion of the statute of limitations. The Administrative Law Judge states that:

"Anthony's representative, acting under a valid power of attorney, executed a consent extending the period of limitation for assessment of sales and use taxes for the period September 1, 1984 through February 28, 1985 to June 20, 1988. There is no evidence of other consents having been executed by petitioners. Petitioners raised no issues with regard to the timeliness of the assessments.

* * *

"[I]t is probable that the notices of determination being contested were issued after the expiration of the three-year period of limitation for assessment of additional sales taxes for periods before June 1, 1985" (Finding of Fact "2" and Conclusion of Law "C," respectively).

This discussion concerns neither the validity of the consent extending the period of limitation for assessment of additional tax nor the existence/ nonexistence of a prior consent. Rather, it addresses the fact that the notices of determination were issued for a period which may have been, in part, after the three-year period of limitation, even as extended by the consent.

Petitioners' sales tax deficiency was calculated for the period September 1, 1984 through November 30, 1987. In this period, the first quarter would end on November 30, 1984. The sales tax return would have been required to be filed within 20 days after the end of the quarter, or by December 20, 1984 (see, Tax Law § 1136[b]). The three-year period of limitation would begin to run from the date the return was filed (see, Tax Law § 1147[b]). The record does not disclose the exact dates upon which petitioners filed their returns; however, for purposes of this discussion, those dates are not necessary.

Assuming the return was filed on or before December 20, 1984, the period of limitation would end on December 20, 1987. However, under these facts, petitioners' representative signed a consent form on November 2, 1987, which extended the period of limitation to June 20, 1988 (see, Exhibit "Q"). Therefore, the statute of limitations defense did not become available to petitioners until June 21, 1988. This is important, because the notices of determination issued by the Division were dated July 20, 1988, one month after the expiration of the period of limitation.

It is this gap, between the period of limitation and the date of the notices of determination, to which the Administrative Law Judge refers in her discussion of the lack of additional consents. Based upon the consent signed by petitioners' representative, the Division might have been barred from assessing petitioners for any quarter prior to June 20, 1985. As petitioners had been assessed for the period September 1, 1984 through November 30, 1987, petitioners might have been able to successfully challenge the assessments for the periods ending November 30, 1984, February 28, 1985, and May 31, 1985, if they had pleaded the statute of limitations as an affirmative defense. To raise the defense, petitioners needed to establish a prima facie case showing the date on which the limitation period commenced, the

expiration of the period, and receipt of mailing of the notice after the running of the period (see, Matter of Jencon, supra; see also, Amesbury Apts. Ltd. v. Commissioner, 95 TC 227; Robinson v. Commissioner, 57 TC 735). However, petitioners' failure to address this issue at the hearing causes the defense to be waived. Petitioners are, therefore, liable for the assessment for the entire period.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Joseph Agnone and Nicola Nappo d/b/a Anthony's Pizzeria, Joseph Agnone as partner of Anthony's Pizzeria and Nicola Nappo as partner of Anthony's Pizzeria is denied;

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

3. The petitions of Joseph Agnone and Nicola Nappo d/b/a Anthony's Pizzeria, Joseph Agnone as partner of Anthony's Pizzeria and Nicola Nappo as partner of Anthony's Pizzeria are granted to the extent indicated in conclusions of law "D" and "E" of the Administrative Law Judge's determination, but are otherwise denied; and

4. The Division of Taxation is directed to modify the notices of determination and demand for payment of sales and use taxes due dated July 20, 1988 in accordance with paragraph "3" above, but such notices are otherwise 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

