

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
TASO'S VIDEO FAIR, INC. : DECISION
for Revision of a Determination or for Refund of Sales and : DTA No. 808603
Use Taxes under Articles 28 and 29 of the Tax Law for :
the Period September 1, 1985 through August 31, 1988. :

Petitioner Taso's Video Fair, Inc., 8915 Fifth Avenue, Brooklyn, New York 11209, filed an exception to the determination of the Administrative Law Judge issued on January 13, 1994. Petitioner appeared by Stephen P. Sophir, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Michael B. Infantino, Esq., of counsel).

Both petitioner and the Division of Taxation filed letter briefs. Petitioner filed a reply letter brief, received on June 23, 1994, which date began the six-month period to issue this decision. Oral argument, requested by petitioner, was denied.

Commissioner Koenig delivered the decision of the Tax Appeals Tribunal. Commissioner Dugan concurs.

ISSUES

I. Whether the Division of Taxation properly utilized an indirect audit method and, if so, whether petitioner has shown error in either the audit method or the audit result.

II. Whether petitioner has shown reasonable cause and an absence of willful neglect to warrant cancellation of penalties imposed herein.

FINDINGS OF FACT

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

On May 30, 1989, following an audit, the Division of Taxation ("Division") issued to petitioner, Taso's Video Fair, Inc., a Notice of Determination and Demand for Payment of Sales and Use Taxes Due which assessed \$53,871.76 in total tax due, plus penalty and interest, for the period September 1, 1985 through August 31, 1988.

Petitioner operates a video rental store. During the period at issue, petitioner's store was located at 8623 Fifth Avenue, Brooklyn, New York. Petitioner's store was open seven days per week from 10:00 A.M. until 9:00 P.M. (Fridays and Saturdays until 10:00 P.M.)

During the relevant period, petitioner had two officers and shareholders. Anthony Kanellopoulos was president and owned 36% of the corporate stock. His brother, Peter Kanellopoulos, was vice-president and owned 64% of the stock. Prior to about September or October 1986, Anthony Kanellopoulos was involved in the daily management of the store. After that time, Anthony Kanellopoulos discontinued his day-to-day involvement and turned such duties over to Peter Kanellopoulos. At some point in 1987, Anthony Kanellopoulos became aware that his brother had a psychiatric illness and a substance abuse problem for which he received treatment, which included several weeks of in-patient care. While he was ill, Peter Kanellopoulos was unable to effectively manage the video store.

In order to rent a video in petitioner's store, a customer had to become a "member". The regular cost of a membership was \$9.95. Petitioner also ran coupon and gift certificate specials providing free memberships to customers. The cost of a video rental ranged from \$1.00 per day to \$2.50 per day. Customer purchases of memberships and video rentals were rung up on petitioner's cash register. New releases were rented at \$2.50 for the first day and \$1.00 per day thereafter. New releases were the most popular with customers. Petitioner had an inventory of 2,500 to 3,000 tapes in the store during the period at issue. Petitioner also sold blank video tapes and rented video game cartridges.

Throughout the audit period petitioner consistently ran promotions through direct mail advertising and newspaper advertising. Such promotions often offered free memberships or "2-for-1" rentals.

The procedure by which a customer rented a video from petitioner was as follows: the customer selected a video; petitioner's employee recorded the selection in the customer's file; the customer subsequently returned the video and paid the charge; petitioner's employee recorded the return of the video in the customer's file.

When an individual became a "member", petitioner created a file which contained a rental activity sheet for that member. Petitioner used such files to record the member's selections and thereby track its inventory. Petitioner maintained in the membership file only the most recent rental activity sheet for each individual member in order to track inventory and to verify the member's signature. Petitioner did not maintain the complete set of its members' rental activity.

The rental activity sheets referred to above identified the video, listed the dates the video was rented and returned, the initials of the employee who checked the video "out" and "in", and the member's signature. For cash transactions, the activity sheets also listed, under the heading "amount due", the number of days the video was out. For non-cash transactions, designations such as "coupon" or "free" were listed under this heading.

By letter dated September 7, 1988, the Division¹ requested petitioner's books and records pertaining to its sales tax liability for the period September 1, 1985 through August 31, 1988 as follows:

"All books and records pertaining to your Sales Tax Liability for the period under audit should be available. Required documents include Sales tax returns and accompanying workpapers, detailed sales book(s), sales journals, all sales invoices, documents supporting the nontaxable status of all untaxed sales (i.e. resale certificates, diplomatic and exempt certificates, shipping records), ledgers, cash register tapes and any type of memoranda prepared for consignment sales. Federal tax returns and New York State

¹The audit herein was conducted by an auditor employed by the Audit Division of the City of New York Finance Department.

WRS-2 wage reporting forms should also be made available. Additional information may be required during the course of the audit."

Subsequent to this request, the Division was advised by petitioner's former representative, a Mr. Visci, that petitioner did not maintain sales invoices or cash register tapes during the audit period.

In the absence of sales invoices or cash register tapes, the Division determined petitioner's taxable sales using an estimated audit method whereby the Division utilized petitioner's cash register tape summary readings for four days to determine petitioner's average daily rentals. In its audit the Division presumed that the register tapes represented video rentals only. Specifically, the Division reviewed petitioner's cash register tapes for October 29, 1988 (Saturday), October 30, 1988 (Sunday), February 27, 1989 (Monday) and February 28, 1989 (Tuesday) and determined sales for these four days as follows:

<u>Date</u>	<u>Total Sales</u>
October 29, 1988	\$ 721.64
October 30, 1988	635.04
February 27, 1989	464.24
February 28, 1989	<u>404.52</u>
Total	\$2,225.44

The Division did not submit copies of the cash register tapes used in its calculation of the assessment herein. The Division's audit report indicates that the Division used petitioner's machine reading numbers as follows: October 29: Z5617, Z5618, Z5619; October 30: Z5824, Z5825, Z5826; February 27: Z75530, Z75532; February 28: Z75667, Z75669. The audit report further indicated that the readings so used were encaptioned "Dept", "Clrk" and "Trans" reports.

The Division next calculated the mean or average daily rentals figure for these four days which equaled \$556.36. This average daily rental figure was then multiplied by the number of days the store was open during the period June 1, 1987 through August 31, 1988, i.e., the five most recent quarters of the audit period, to reach video rentals totaling \$253,143.80 for this period.

While present in petitioner's store, the Division also reviewed petitioner's records of members. Such review revealed that petitioner gained 3,820 members during the entire audit period. Using petitioner's regular fee for a membership of \$9.95, the Division thus determined \$38,009.00 in membership fees for the entire audit period. The Division then determined a membership fee per quarter figure for the audit period (\$38,009.00 divided by 12) and multiplied this per quarter figure by five to reach a membership fee figure of \$15,837.10 for the five quarters comprising the period June 1, 1987 through August 31, 1988.

The audited video rental amount and membership fee amount for the June 1, 1987 through August 31, 1988 period were totaled and then divided by gross sales reported for the same period. The resulting margin of error of 1.2143 was applied to petitioner's taxable sales reported throughout the audit period to reach additional taxable sales for the audit period of \$652,991.04. The Division then applied the prevailing sales tax rate of 8.25% to reach additional tax asserted due herein of \$53,871.76.

Also during the course of the audit, the Division compared petitioner's reported gross sales during the audit period as indicated by its sales tax returns, its bank deposits² and its Federal income tax returns. This comparison indicated that for the period February 1, 1986 through August 31, 1988 petitioner's bank deposits exceeded petitioner's reported gross sales per its sales tax returns by \$117,602.00. Additionally, for the years 1986 and 1987³, petitioner's gross sales as indicated by its Federal income tax returns exceeded gross sales as indicated by its sales tax returns by \$72,754.00.

During the course of the audit, the auditor did not specifically ask to review petitioner's membership files, nor were such files made available to the auditor during the course of the audit.

²Petitioner provided the Division with copies of its bank statements during the course of the audit.

³As indicated in the auditor's workpapers, "1986" included February 1, 1986 through January 31, 1987, and "1987" included February 1, 1987 through January 31, 1988.

Petitioner submitted into the record a sample of its member activity sheets as described above. With a few exceptions where the sheets bore a date within the audit period, it cannot be determined whether such sheets documented rental activity during the audit period. Petitioner conceded that the sample included activity sheets from outside the audit period.

Petitioner submitted into the record a plastic bag of coupons which purportedly had been used by customers to rent videos subsequent to the audit period. Anthony Kanellopoulos testified that it was petitioner's practice to ring up all sales (including coupon sales) as cash and to charge the customer the difference between the total rung up and the value of the coupon. Mr. Kanellopoulos further testified that it was petitioner's procedure that the coupons submitted by the customer were marked with the customer's membership number and the value of the coupon. A review of the coupons submitted reveals that very few have any such markings thereon.

During the audit period petitioner did not retain its cash register tapes or coupons. Mr. Kanellopoulos testified that such tapes were discarded because they did not accurately reflect the amount of cash taken in by petitioner. Mr. Kanellopoulos testified that a summary or "Z" reading was taken from petitioner's register each day and that such reading was reconciled each day to the amount of cash and coupons taken in. Mr. Kanellopoulos further testified that such daily reconciliation sheets were destroyed on an approximately monthly basis. Additionally, Mr. Kanellopoulos testified that all cash receipts were deposited in petitioner's bank account with the exception, during 1988, of petitioner's payroll which was paid in cash.

Petitioner submitted into the record a Video Retailer Survey 1989 published by Video Store Magazine. Included in this survey were the following statistics regarding weekly rental activity of retail video stores: Sunday 11%; Monday 9%; Tuesday 8%; Wednesday 8%; Thursday 8%, Friday 22%; Saturday 34%. This statistical information was based on responses of 378 video retailers from 44 states.

Petitioner introduced into the record copies of daily summary cash register readings for the months of October 1988 and February 1989, together with copies of what were assertedly daily reconciliation sheets by which petitioner reconciled the tapes to its actual cash receipts. No documents, i.e., coupons, were submitted to verify the reconciliations and no information contained on the tapes supported petitioner's reconciliations. The tapes themselves list, under the heading "Dept Reprt", various categories of purchases such as "rental", "ad. day", "member", and "access" along with the number and total amount of purchases in each such category. By dividing the total amount of purchases in each category by the number of such purchases reveals purchase prices as follows: "rental" \$2.50; "ad. day" \$1.00; "member" \$9.95. The tapes submitted by petitioner contain no sales tax category. Also, based on the purchase prices (indicated above), it does not appear that the total amount of purchases on the tapes submitted included sales tax.

Among the cash register summary readings submitted by petitioner were the following:

<u>Date</u> ⁴	<u>Machine Reading #</u>	<u>Total Sales Indicated on Tape</u>
10/30/88	Z5617	\$666.64
10/31/88	Z5824	586.64
2/28/89	Z5530	464.24
3/1/89	Z5667	404.52

At the top of each tape, the date and time was listed. The time so listed was consistently in the 10:00 P.M. to 11:00 P.M. range.

⁴The dates as listed on the register tapes submitted by petitioner are somewhat confusing. The Division indicated that the tapes used in the audit were from October 29 and 30, 1988 and February 27 and 28, 1989. The dates listed on these four machine readings, which were in fact used by the Division on audit (see above), would seem to indicate that the four-day observation period was actually October 30 and 31, 1988 and February 28 and March 1, 1989. The discrepancy would appear to have no impact, however, upon the audit results herein.

It should also be noted with respect to the dates listed on the tapes that all of the cash register tapes submitted by petitioner and the sample submitted by the Division indicated "87" as the year. This discrepancy was explained by Mr. Kanellopoulos as a failure to reprogram the register to reflect changes in the year. Given that the sample submitted by the Division and the four tapes listed above (which were used by the Division on audit) all indicated "87" as the year, petitioner's explanation of this discrepancy is accepted.

The cash register summary tapes submitted by petitioner indicated a sales activity for the 31 days of October 1988 of \$13,275.04 and for the 28 days of February 1989 of \$10,875.24, with an average daily sales amount for the two months of \$409.33.

At hearing, petitioner introduced certain evidence indicating that, while it gained 3,864 memberships during the audit period as the Division asserted on audit, only 1,252 of such memberships were paid memberships. The balance of such memberships were "no charge" memberships. At hearing, the Division accepted petitioner's assertions regarding the number of paid memberships during the audit period.

OPINION

In the determination below, the Administrative Law Judge held that the Division's letter dated September 7, 1988 constituted an unequivocal request for petitioner's books and records for the entire audit period and since petitioner did not maintain cash register tapes or sales invoices, the Division's use of an indirect audit methodology was proper.

The Administrative Law Judge also: 1) rejected petitioner's contention that its books and records were sufficient for the purpose of verifying taxable sales and that the auditor failed to thoroughly review such records during the audit; 2) held that the cash register tape summaries for the months of October 1988 and February 1989 submitted into evidence by petitioner do constitute an accurate summary of its sales activity for those two months, and directed the Division to recompute petitioner's audited average daily sales using said summaries; 3) held that petitioner failed to prove its assertions, due to lack of supporting documentation in the record, that coupon sales were rung up as cash sales during the relevant period; 4) held that it appears that the Division's total sales figures for October 29 and 30, 1988 improperly included sales tax; 5) directed the Division to modify its assessment by eliminating the membership fees component from the calculation of total additional taxable sales for the period June 1, 1987 through August 31, 1988, as the register tapes did include the membership sales; and 6) sustained the penalties assessed against petitioner.

On exception, petitioner argues that: 1) the books and records are sufficient and adequate for an audit; 2) the City of New York Department of Finance did an audit and found that there were no additional taxes due based on the income of petitioner; 3) while petitioner's register tapes were utilized, no consideration was given to the use of coupons and promotions even though petitioner has clearly established that it relied on promotions and coupons to solicit customers; 4) penalties should be abated due to health problems of Peter Kanellopoulos; 5) all rentals are recorded as sales whether or not a coupon is used; and 6) it would be impossible for petitioner's store due to its size, part-time help, one register, video inventory and number of customers to generate the amount of sales the auditor suggests.

The Division, in reply, refers the Tax Appeals Tribunal to its letter memorandum filed below in this matter and argues that the Administrative Law Judge's determination should be, in all respects, sustained since the facts conform to the evidence and, further, the conclusions of law correctly determine all issues raised by petitioner on exception.

The Division also argues that petitioner has improperly attached to its notice of exception documents pertaining to a City of New York Department of Finance audit, which documents were rejected by the Administrative Law Judge at hearing and were again returned to petitioner after being submitted as part of petitioner's post-hearing memorandum.

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

However, we must address and reject petitioner's attempt to place before this Tribunal additional evidence in the form of documents relating to a City of New York Department of Finance audit of petitioner, said documents having been rejected as evidence by the Administrative Law Judge were not part of the record below.

As we held in Matter of Schoonover (Tax Appeals Tribunal, August 15, 1991):

"[i]n order to maintain a fair and efficient hearing system, it is essential that the hearing process be both defined and final. If the parties are able to submit additional evidence after the record is closed, there is neither definition nor finality to the hearing. Further, the submission of evidence after the closing of the record denies the adversary the right to question the evidence on the record. For these reasons we must follow our policy of not allowing the submission of evidence after the closing of the record (see, Matter of Oggi Rest., Tax Appeals Tribunal November 30, 1990; Matter of Morgan Guar. Trust Co. of N.Y., Tax Appeals Tribunal, May 10, 1990; Matter of International Ore & Fertilizer Corp., Tax Appeals Tribunal, March 1, 1990; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989; Matter of Modern Refractories, Tax Appeals Tribunal, December 15, 1988)."

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Taso's Video Fair, Inc. is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Taso's Video Fair, Inc. is granted to the extent indicated in conclusions of law "G," "I," "J" and "L" of the determination of the Administrative Law Judge, but in all other respects is denied; and
4. The Division of Taxation is directed to modify the Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated May 30, 1989 in accordance with paragraph "3" above, but in all other respects such Notice is sustained.

DATED: Troy, New York
November 10, 1994

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

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