

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
NUSCO, INC.	:	DECISION
AND PETER PORCELLI, AS OFFICER	:	DTA No. 809581
	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1985	:	
through May 31, 1988.	:	

Petitioners Nusco, Inc. and Peter Porcelli, as Officer, 134 Fendale Street, Franklin Square, New York 11010, filed an exception to the determination of the Administrative Law Judge issued on April 8, 1993. Petitioners appeared by Gary Schoer, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Donald C. DeWitt, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Any reply brief submitted by petitioners was due on October 26, 1993, which date began the six-month period for issuance of this decision. Oral argument was not requested.

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

ISSUES

I. Whether petitioners have sustained their burden of proof to show that the audit method or amount of tax assessed was erroneous.

II. Whether petitioners have sustained their burden of proof to show that the failure to properly report and pay sales tax was due to reasonable cause and not willful neglect.

FINDINGS OF FACT

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

During the period at issue, petitioner Nusco, Inc. ("the corporation") operated a pizzeria and restaurant under the name "Sergio's" at 376 Merrick Avenue, East Meadow, New York. Petitioner Peter Porcelli was president and sole shareholder of the corporation.

The business was open seven days a week. The hours of operation were 11:00 A.M. to 10:00 P.M. Monday through Saturday, but 11:00 A.M. to a somewhat earlier closing hour on Sunday. The restaurant had a counter, tables and chairs and also provided a delivery service. The restaurant sold pizza, Italian food, soda and beer.

An audit of the corporation's books and records for the period March 1, 1985 through November 30, 1987 was commenced on February 1, 1988. The audit methodology and findings were as follows:

(a) The auditor requested all pertinent books and records. The records produced were sales tax returns and worksheets, Federal income tax returns, cash receipts worksheet and check disbursements worksheet. The corporation did not maintain cash register tapes or guest checks. Sales were found to have been based on bank deposits added to cash payouts. There was no internal control over the recording and reporting of cash or sales, or of purchases.

(b) Gross sales per records did not reconcile with sales reported on the Federal income tax returns and sales tax returns.

(c) Purchases per records did not reconcile with purchases reported on the Federal income tax returns.

(d) The auditor obtained third-party verification of the corporation's cheese purchases from C & F Dairy Co., Inc. for the quarter ending February 28, 1986. It was determined that the corporation purchased 5,764 pounds of mozzarella cheese during such quarter. The auditor noted that cheese purchases of \$10,423.55 for the three months were greater than the

corporation's total year's purchases per Federal income tax returns of \$9,238.00.¹

(e) The auditor also determined that the corporation purchased 1,550 pounds of cheese from another supplier, Napoli Foods, Inc., for the quarter ending November 30, 1986. This figure, however, was not used in the auditor's calculations.

(f) An observation of the corporation's business was conducted on April 19, 1988, a Tuesday, from 11:00 A.M. to 8:30 P.M. Gross sales were \$228.47, plus tax.¹ The soda and beer-to-pizza ratio was 20.93% and the meals-to-pizza ratio was 45.96%.² The average pizza price was found to be \$7.08.

(g) The auditor used a recipe for a 12-inch pizza converted proportionately for an 18-inch pizza, calculating .63 pounds of cheese per pie, but actually used .75 pounds per pie at an average selling price of \$7.08 per pie in the initial estimate.

(h) At a pre-assessment conference, petitioners' representative claimed that Sergio's was well known for its generous use of cheese, requesting that the auditor allow 1½ pounds of mozzarella per pie. The auditor obligingly adopted the 1½-pound figure. Also, the price of each pie was reduced from \$7.08 to \$6.00, to reflect lower prices prevailing during the earlier portion of the audit period.

¹Exhibit "F," worksheets, p. 23.

²Exhibit "F," worksheets, p. 24. It is noted that page 23 of the worksheets shows slightly lower ratios, apparently because the earlier calculation did not include luncheon specials for beer and soda and did not include calzone, sausage and "garlic knots" as meals.

(i) Additional taxable sales were calculated as follows:

	Quarter Ending 2/28/86
Cheese purchased	5,764.00 lbs.
Less: 15% used for other meals	864.60 lbs.
2% for waste	<u>115.28 lbs.</u>
Net pounds used in pies	4,784.00 lbs.
Number of pies @ 1½ lbs. cheese per pie	3,189
Average selling price per pie	\$ 6.00
Pie sales	\$19,134.00
Meals @ 0.4596	\$ 8,794.00
Soda & beer @ 0.2093	<u>\$ 4,005.00</u>
Taxable Sales	\$31,933.00

The corporation had reported taxable sales of \$9,540.00 for said quarter; accordingly, additional taxable sales were \$22,393.00 and the margin of error was determined to be 2.3473.

(j) The margin of error was applied to taxable sales reported for each of the quarters in the period March 1, 1985 through May 31, 1988, resulting in tax due of \$35,668.07.

(k) On June 8, 1988, Peter Porcelli, as president of the corporation, executed a consent extending the period of limitation for assessment of sales and use taxes for the period March 1, 1985 through February 28, 1986, to June 20, 1989.

On December 20, 1988, the Division of Taxation ("Division") issued notices of determination and demands for payment of sales and use taxes due to the corporation and to Peter Porcelli, as officer, in the following amounts:

<u>Period</u>	<u>Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
3/1/85 - 5/31/88	\$35,668.07	\$8,878.12	\$8,188.94	\$52,735.13
6/1/85 - 5/31/88 (omnibus penalty)	-0-	3,447.38	-0- 3,447.38	

A Bureau of Conciliation and Mediation Services conference was held on May 15, 1990. Petitioners' representative produced invoices of C & F Dairy Co., Inc. for the period

December 1, 1985 through May 31, 1988³ and an analysis⁴ purporting to show that the margin of error actually declined over the audit period, because cheese purchases fell while reported taxable sales increased, i.e.:

<u>Quarter Ending</u>	<u>Pounds of Cheese Purchased</u>	<u>Reported Taxable Sales</u>
2/28/86	5,764	\$ 9,540.00
5/31/86	4,793	10,093.00
8/31/86	5,325	15,731.00
11/30/86	4,359	15,926.00
2/28/87	4,390	15,856.00
5/31/87	4,424	16,550.00
8/31/87	3,915	18,716.00
11/30/87	3,393	18,944.00
2/28/88	2,996	22,240.00
5/31/88	2,127	22,621.00

By conciliation orders dated August 31, 1990, the conferee denied petitioners' requests and sustained the assessments.

It was noted at the hearing that the analysis provided to the conferee and which was received in evidence at the hearing did not include the 1,550 pounds of cheese purchased from Napoli Foods, Inc. during the quarter ending November 30, 1986. Petitioners' representative was granted until March 31, 1992 to submit additional invoices from Napoli Foods and amend the analysis, if necessary. Nothing, however, was submitted.

OPINION

The Administrative Law Judge determined that the records offered by petitioners to the Division at audit were inadequate:

"as the corporation failed to maintain cash register tapes or guest checks and there were no internal controls over the recording and reporting of cash or sales. Moreover, purchases per records could not be reconciled to the Federal income tax returns and the gross sales per records were not in agreement with sales reported on the Federal income tax returns and/or sales tax returns. Accordingly, the auditor was authorized to reconstruct

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Petitioners' Exhibit "3."

⁴Petitioners' Exhibit "2."

the corporation's sales by use of external indices" (Determination, conclusion of law "C").

The Administrative Law Judge determined that the audit methodology used by the Division was reasonable. Specifically, he determined that:

"[t]he corporation's purchases of cheese for the test period were uncontroverted and the auditor used the very liberal 1 1/2 pounds of cheese per pizza figure which was requested by petitioners' representative. The auditor used the observation test to determine the ratio of meals and drinks to pizza. The total sales for the day of observation, a Tuesday, does not reflect the true typical daily sales which, as the auditor pointed out, would in all probability have been substantially greater if Friday and Saturday sales were taken into consideration" (Determination, conclusion of law "D").

The Administrative Law Judge noted also that the auditor's observation ended at 8:30 P.M., while the business was open six days a week until 10:00 P.M. The Sunday closing time was unknown.

The Administrative Law Judge pointed out that petitioners offered no testimonial evidence at the hearing and rejected, as "suspect," petitioners' argument that sales declined after the test quarter because promotional sales ended.

Finally, the Administrative Law Judge determined that petitioners failed to sustain their burden of proof to show that the failure to properly report and pay sales tax was due to reasonable cause and not to willful neglect.

On exception, petitioners assert, as they did at hearing, that the audit methodology was not reasonable. Specifically, petitioners assert:

"[i]n the instant case, the margin of error methodology utilized by the auditor relied on an unrepresentative small test period which was demonstrated by NUSCO to have been unreasonable and erroneous. Upon all of the evidence presented, it was demonstrated that while cheese purchases remained relatively constant throughout the audit period, reported taxable sales in other quarters were substantially greater than in the test quarter which was a promotional period. The margin of error, therefore, should have been much less than that utilized by the auditor making both the methodology, and the assessment itself, erroneous.

"Clearly, the auditor's own observations during the on-site inspection belied the sales extrapolated by the margin of error methodology. It is beyond imagination that this small storefront pizzeria with limited personnel could have physically done the amount of sales

the audit concluded were consummated. Additional information should have been obtained from suppliers or a larger test period should have been utilized in order for a margin of error audit to have been reasonable in light of all the circumstances. Preferably, additional on site observation should have been utilized to establish a non-erroneous assessment of NUSCO's tax liability.

"Upon all of the evidence, the methodology utilized was unfair, unrepresentative and improper, and the tax assessed was erroneous. The determination of the Administrative Law Judge should therefore be set aside and a reaudit conducted" (Petitioners' brief on exception, pp. 4-5).

Petitioners also assert that they were denied due process of law stating that:

"Article I §6 of the New York State Constitution provides that 'no person shall be deprived of...property without due process of law.' It is axiomatic that the proceeding herein is subject to this constitutional requirement [cite omitted] and that the controlling standard is one of 'fairness and justice,' [cite omitted].

"Of course, advance notice of the issues to be heard at the hearing so that preparation can be adequate is a due process requirement, [cite omitted]. Herein, despite meetings pursuant to regulations held prior to the hearing, the auditor for the first time at the hearing presented additional information which was not part of either the audit or the notice of determination previously served. The Administrative Law Judge permitted this information to be introduced and in fact, utilized it in his determination. Such action was constitutionally infirm" (Petitioners' brief on exception, pp. 5-6).

Petitioners also assert that:

"the representation provided to NUSCO [at hearing] was willfully inadequate. While NUSCO is aware that it had a right to retain whoever it wished, in the instant case, the lack of viable representation was so below the minimum standard to be expected as to constitute ineffective assistance of counsel. Unfortunately, because of the advice of this inadequate counsel, the taxpayer was not present at the hearing and was not aware until the transcript of the hearing was recently received that its representative was unprepared, presented no evidence on its behalf, could not even properly frame a question on cross-examination and failed to provide requested information to the Administrative Law Judge. That such actions were so below the minimum standard expected, was clearly visible to the Administrative Law Judge and his failure to either act or advise NUSCO constitutes denial of due process of law requiring a new hearing herein" (Petitioners' brief on exception, pp. 6-7).

On exception, the Division asserts that the Administrative Law Judge was correct in finding that the audit methodology used by the Division to estimate petitioners' taxable sales was reasonable and that petitioners did not show that the failure to properly report and pay sales

tax was due to reasonable cause, not to willful neglect. The Division asserts that it did not present, for the first time at hearing, any information upon which the audit was conducted or the assessment based.

The Division also asserts that "petitioners were represented before the Division of Tax Appeals and not denied due process of law" (Division's brief, p. 12). The Division points out that petitioners were represented by a Certified Public Accountant, "a person authorized by the Rules of Practice of the Tax Appeals Tribunal to represent persons before the Division of Tax Appeals (20 NYCRR 3000.2[a][2]) . . . who was duly authorized by a Power of Attorney . . . to represent it in this matter" (Division's brief, p. 12).

We deal first with the issue of whether the audit methodology was reasonable. The crux of petitioners' assertion is that "[t]he margin of error . . . should have been much less than that utilized by the auditor" (Petitioner's brief, p. 4). We cannot agree. Exactness is not expected when the Division makes an estimation of tax due, as such accuracy was prevented by petitioners' failure to maintain adequate records (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454). Rather, when estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (Matter of Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869). The burden is on the taxpayer to demonstrate by clear and convincing evidence that the audit method employed was unreasonable (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). The reasonableness of the audit was fully and correctly dealt with by the Administrative Law Judge and we affirm for the reasons stated in his determination.

We next reject petitioners' assertion that they were denied due process because of the use of information at the hearing of which they were not apprised of prior to hearing. The information referred to is apparently the Division's Exhibit "G," which was prepared by the auditor the day prior to the hearing. The exhibit reviews the C&F and other invoices submitted by petitioners at the conciliation conference (Tr., p. 56) in connection with petitioners' Exhibits "2" and "3," introduced at hearing, which purported to show that the margin of error actually declined over the audit period because cheese purchases fell while reported taxable sales increased. The sole purpose of Exhibit "G" was to show that such was not the case. In no way did the exhibit alter the fact that the sole basis of the assessment was the cheese purchases from C&F, coupled with the observation test. Moreover, the Administrative Law Judge allowed petitioners the opportunity to submit additional information on the exhibit post hearing (Tr., pp. 62, 67, 79 and 80). In short, there was no surprise to petitioners from the information in Exhibit "G."

We next reject petitioners' assertion that they should be granted a new hearing for want of effective representation at hearing. We note that with certain narrow exceptions not relevant here:

"the right to the effective assistance of counsel (U.S. Const., 6th Amdt.; N.Y. Const., art. I, s 6) does not extend to civil actions or administrative proceedings (see, generally, *Matter of Brown v. Lavine*, 37 N.Y.2d 317, 372 N.Y.S.2d 75, 333 N.E.2d 374; *Matter of Rivera v. Blum*, 98 Misc. 2d 1002, 420 N.Y.S.2d 304)" (see, *Walston v. Axelrod*, 103 AD2d 769, 477 NYS2d 400, 401, lv denied 64 NY2d 611, 490 NYS2d 1024; see also, *Matter of Sasson v. Commissioner of Education*, 127 AD2d 875, 511 NYS2d 696; *Matter of Allen v. Board of Regents*, 140 AD2d 824, 528 NYS2d 211).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Nusco, Inc. and Peter Porcelli, as Officer is denied;
2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Nusco, Inc. and Peter Porcelli, as Officer is denied; and
4. The notices of determination dated December 20, 1988 are sustained.

DATED: Troy, New York
March 31, 1994

/s/John P. Dugan

John P. Dugan
President

/s/Francis R. Koenig

Francis R. Koenig
Commissioner