

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

KARAY RESTAURANT CORPORATION :

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 June 1, 1990 through November 30, 1992. :

In the Matter of the Petition :

of :

CHRISTOS KARAYIANNIS, AS OFFICER OF :
KARAY RESTAURANT CORPORATION :

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 June 1, 1990 through November 30, 1992. :

In the Matter of the Petition :

of :

JOHN KARAYIANNIS, AS OFFICER OF :
KARAY RESTAURANT CORPORATION :

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 June 1, 1990 through November 30, 1992. :

DECISION
DTA NOS. 814615
814616, 814617
AND 814618

In the Matter of the Petition	:
of	:
PETER KARAYIANNIS, AS OFFICER OF	:
KARAY RESTAURANT CORPORATION	:
	:
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 June 1, 1990 through November 30, 1992.	:

Petitioners Karay Restaurant Corporation, 63-68 Austin Street, Rego Park, New York 11374, Christos Karayiannis, as officer of Karay Restaurant Corporation, 23 Jackie Drive, Westbury, New York 11590-2807, John Karayiannis, as officer of Karay Restaurant Corporation, 138 Stratford Avenue, Garden City, New York 11530-2737 and Peter Karayiannis, as officer of Karay Restaurant Corporation, 800 Fifth Avenue, Apt. 27D, New York, New York 10021, filed an exception to the determination of the Administrative Law Judge issued on June 19, 1997. Petitioners appeared by Murphy & O'Connell (Patrick J. Murphy, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (James Della Porta, Esq., of counsel).

Petitioners requested time to file a brief, but no brief was filed. The Division of Taxation filed a brief in opposition and petitioners filed a reply brief. Oral argument, at the request of petitioners, was heard on June 10, 1998 in Troy, New York.

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

ISSUES

I. Whether the method used by the Division of Taxation to determine the sales tax liability of Karay Restaurant Corporation for the period June 1, 1990 through November 30, 1992 was rational.

II. If it is determined that the audit method was rational, whether petitioners overcame the presumption of validity by offering clear and convincing evidence that the tax assessed is incorrect.

III. Whether petitioners can properly raise new factual issues for the first time in their reply brief on exception.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact “1,” “4” and “6” which have been modified. The Administrative Law Judge’s findings of fact and the modified findings of fact are set forth below.

Finding of fact “1” of the Administrative Law Judge’s determination is modified to read as follows:

Petitioner, Karay Restaurant Corporation d/b/a Shalimar Diner, operated a diner at 63-68 Austin Street, Rego Park, New York 11374. The diner was opened for business between the hours of 6:00 A.M. and 12:00 midnight seven days a week. Christos, John and Peter Karayiannis were the owners and officers of the corporation. None of the officer-owners, in their petitions or at hearing, denied their status as persons having a duty to act on behalf of the corporation.¹

¹We have modified finding of fact “1” of the Administrative Law Judge’s determination by adding the last sentence to clarify the nature of petitioners’ claims.

On March 17, 1994, following an audit of Karay Restaurant Corporation's ("Karay") available books and records, the Division of Taxation ("Division") issued a Notice of Determination for Payment of Sales and Use Taxes Due against Karay covering the period June 1, 1990 through November 30, 1992, for taxes due of \$58,734.31, plus penalty and interest. The penalty assessed to Karay included additional penalty pursuant to Tax Law § 1145(a)(1)(vi) for omitting more than 25 percent of the actual taxes found due in each of the quarterly periods.

On April 27, 1994, the Division issued notices of determination to Christos Karayiannis, John Karayiannis and Peter Karayiannis as officers of Karay for the same period and the same amount of taxes. Penalties assessed also included the additional penalty pursuant to Tax Law § 1145(a)(1)(vi) for omitting more than 25 percent of the actual taxes found due in each of the quarterly periods.

Finding of fact "4" of the Administrative Law Judge's determination is modified to read as follows:

The Division began the audit by mailing to Karay a standard form audit appointment letter dated December 9, 1992. In addition to setting a date and time for the first meeting between petitioner Karay and the Division's auditor, this letter specifically requested that petitioner make available at the time of the first meeting all books and records pertaining to petitioner's sales tax liability for the period under review. The letter indicated that the period under review was June 1, 1990 through November 30, 1992. In the letter, the Division requested that the corporation make available for the auditor all journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns, exemption certificates, guest checks and bank statements maintained for the audit period. Accompanying the letter was a list of specific records requested by the Division. During the audit, the

Division's auditor was not provided with a general ledger, sales invoices, guest checks or a complete set of purchase invoices.²

The restaurant had been in operation since 1974 and this was the fourth time it had been subject to audit. The corporation had been advised by the Division during the previous audit to maintain guest checks, but had continuously failed to do so. During the present audit, petitioners had been instructed by the auditor on at least three occasions to start saving guest checks, but the restaurant failed to save them.

Finding of fact "6" of the Administrative Law Judge's determination is modified to read as follows:

A document in the Field Audit Report known as the "Tax Field Audit Record" shows that the auditor reviewed the books and records made available by petitioner for the audit period. Due to the lack of records provided and inadequate recordkeeping, especially the failure to retain the guest checks used in their business, the auditor decided to estimate sales on the basis of external indices. The auditor concluded that the lack of guest checks resulted in inadequate internal control procedures in the business operation and rendered the records unusable to trace transactions back to the original source or forward to a final total.³

The last audit the Division had performed of the restaurant involved the years just prior to the years at issue. Observation tests of the business's operations had been performed on July 13 and 16, 1990. These dates fell within the first quarter of the present audit. Adjustments were made to the amount determined of 11 ½ percent because of the excessive heat on the observation days and of 3 1/3 percent for nontaxable sales, resulting in taxable sales per day of \$3,309.00 and

²We have modified finding of fact "4" of the Administrative Law Judge's determination to include purchase invoices as among the records not provided to the auditor.

³We have modified finding of fact "6" of the Administrative Law Judge's determination to more completely reflect the record.

taxable sales per quarter of \$301,119.00. The auditor compared this figure with the amount reported by the restaurant, \$222,407.00, in the quarter in which he performed another observation test on June 9, 1993 and determined that there was a 26.13984 percent reduction in the taxable sales of the restaurant over the period between the August 31, 1990 quarter and the August 31, 1993 quarter. The observation test resulted in taxable sales for the quarter ended August 31, 1993 to be \$230,048.00, but the auditor used the amount reported by the restaurant in determining the percentage reduction in taxable sales. By dividing the percentage reduction by the 12 quarters in the period of time between observation tests, the auditor determined that the taxable sales of each quarter were to be reduced by an average of 2.17832 percent. The auditor was able to spread the 26.13984 percent reduction in taxable sales over this period by reducing each quarter by 2.17832 percent. The audit resulted in additional taxable sales of \$711,931.00 and additional tax due of \$58,741.31.

During the audit Karay, by its representative, executed two consents extending the period of limitation for assessment of sales and use taxes under articles 28 and 29 of the Tax Law which collectively extended to September 20, 1994 the date by which the Division could assess tax due for the period June 1, 1990 through February 20, 1991.

At the hearing, the Division's representative conceded that, based upon *Matter of Bleistein* (Tax Appeals Tribunal, July 27, 1995), the first three quarters of the notices of determination issued against the three officers should be canceled, reducing the amounts of tax assessed by \$14,064.52 and leaving the amount of tax due at \$44,669.79. In *Bleistein*, the Tax Appeals Tribunal held that the "only tax that can be assessed during the extended period is the tax of the taxpayer who signed the consent extending the period of limitations." As there was no consent

extending the period of limitations for the officers, but only for the corporation, assessments against the officers for the first three quarters were untimely.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge determined that despite the Division's repeated, clear and unequivocal requests for records, petitioners failed to maintain and make available records sufficient to verify their sales for the period under review. Indeed, despite several requests by the Division during this and prior audits for petitioners to maintain guest checks, petitioners failed to produce any guest checks or other sales source documentation. The Administrative Law Judge determined that without guest checks, the Division could not verify the accuracy of petitioners' cash register tapes (*see, Matter of Korba v. New York State Tax Commn.*, 84 AD2d 655, 444 NYS2d 312, *lv denied* 56 NY2d 502, 450 NYS2d 1023) and, accordingly, the Division was authorized under Tax Law § 1138(a) to estimate petitioners' sales tax liability.

The Administrative Law Judge noted that the reasonableness of the audit method can only be determined based on information made available to the auditor at the time of audit (*Matter of Queens Discount Appliances*, Tax Appeals Tribunal, December 30, 1993), and it is the taxpayer who bears the burden of proving by clear and convincing evidence that the audit methodology was unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of MNS Cards & Gifts*, Tax Appeals Tribunal, May 7, 1992). The Administrative Law Judge pointed out that, in this case, petitioners failed to produce any source documentation of their sales in response to the Division's repeated requests. Additionally, petitioners' representative advised the Division that petitioners did not have guest checks, and petitioners failed to begin maintaining their guest checks even after several requests by the

auditor to do so. The Administrative Law Judge pointed out that the use of information gleaned from prior audits, and the use of observation audits, have both been sustained as reasonable methods of arriving at taxable sales (*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 Burbacki*, Tax Appeals Tribunal, February 9, 1995; *Matter of C & L Systems*, Tax Appeals Tribunal, August 11, 1994). Accordingly, the Administrative Law Judge determined that the method selected by the Division was reasonably calculated to reflect the tax due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75).

Since the Administrative Law Judge determined that the audit method selected was rational, the burden was upon petitioners to establish by clear and convincing evidence that the tax assessed herein was erroneous (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679).

Petitioners did not introduce any documentary evidence at hearing nor did they have any witnesses provide testimony to support their claim that the use of the observation test to estimate additional sales tax due was unreasonable. Petitioners also failed to offer any evidence in support of their claim that the closing of a department store four blocks down the street from petitioners' business location caused a decrease in their sales.

Since petitioners offered no evidence in support of their claims, the Administrative Law Judge determined that petitioners failed to meet their burden of establishing by clear and convincing evidence that the tax determined to be due was erroneous (*Matter of Meskouris Bros. v. Chu*, *supra*; *Matter of Surface Line Operators Fraternal Org. v. Tully*, *supra*).

With regard to penalties, the Administrative Law Judge pointed out that penalties may be abated when it is determined that a taxpayer's failure to pay tax was due to reasonable cause and not due to willful neglect (Tax Law § 1145[a][1][iii]). Here again, the burden of proof was on petitioners to show that reasonable cause existed for abatement of penalties (*Matter of F & W Oldsmobile v. State Tax Commn.*, 106 AD2d 792, 484 NYS2d 188). The Administrative Law Judge found no evidence in the record to establish reasonable cause for petitioners' failure to pay the tax due. Therefore, the Administrative Law Judge determined that there was no basis for abating penalties.

On the contrary, the Administrative Law Judge determined that petitioners' failure to maintain accurate records, failure to maintain guest checks and the large deficiency resulting from the current audit are all evidence of willful neglect and militate against the waiver of the penalties herein.

ARGUMENTS ON EXCEPTION

At oral argument, petitioners' counsel admitted that guest checks are used by Karay Restaurant. A customer is given a guest check showing the amounts they owe and the customer then goes to the register and pays the amount shown on the guest check. The guest checks are then thrown in the trash because, according to petitioners' counsel, "they are not useful" (Oral Argument Tr., p. 23). Petitioners' counsel stated that his clients "found it very cumbersome to keep the things they felt were unnecessary. They had used them [the guest checks] themselves. I mean it's a convenience" (Oral Argument Tr., p. 23 [lines 17-20]).

Petitioners now argue that they had adequate books and records. Petitioners urge further that they can properly raise this claim for the first time on exception based on the Appellate

Division's decision in *Matter of King Crab Rest. v. Chu* (134 AD2d 51, 522 NYS2d 978). The fact that petitioners did not retain the requested guest checks does not matter, petitioners argue, because the decision in *King Crab* holds that guest checks are not necessary. The important thing, petitioners urge, is that they had cash register tapes. Since petitioners had cash register tapes, they argue their books and records were adequate. Since they had adequate books and records, petitioners believe that the Division was required to conduct a detailed audit and could not properly rely, as it did, on an observation test to arrive at the tax due.

Further, petitioners argue that the Division's audit was unreasonable, because they were not given proper credit for the decline in business resulting from the closing of Alexander's Department Store four blocks from their business location.

OPINION

Petitioners raised the factual issue of the adequacy of their records for the first time on exception. Petitioners now claim that since they had cash register tapes, their records were adequate and the Division could not resort to an observation test to arrive at the tax asserted due. We have consistently held that the raising of new factual issues after the closing of the record is not permitted, since to do so would be prejudicial to the opposing party by depriving it of the opportunity to present evidence on the disputed issue (*see, Matter of Sandrich, Inc.*, Tax Appeals Tribunal, April 15, 1993; *Matter of Consolidated Edison Co. of New York*, Tax Appeals Tribunal, May 28, 1992). Petitioners never claimed they had adequate records before filing their exception. By standing mute on this factual question while the record was open, petitioners surrendered to the Division's allegation and the Administrative Law Judge's determination that their records were inadequate.

In any event, the record in this case supports the conclusion that petitioners' books and records were inadequate. We note that petitioners' argument that its records were adequate rests on the dual claims that its books and records were not adequately reviewed by the auditor (*citing Matter of King Crab Rest. v. Chu (supra)*) and that the decision in that case holds that guest checks are not necessary.

The auditor's testimony at hearing does not directly address his review of petitioners' books and records prior to arriving at the conclusion that they were inadequate. However, we find that the audit report in evidence, particularly the auditor's action sheets, establish that the auditor reviewed such books and records as were provided by petitioners prior to concluding that the books and records were inadequate (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109; *Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41). This portion of petitioners' argument is, therefore, rejected.

We also reject petitioners' claim that *King Crab* stands for the proposition that guest checks are not necessary. First, the facts in *Matter of King Crab Rest. v. Chu (supra)* are directly opposite to those here. In that case, the auditor was presented with *guest checks*, bank statements, a general ledger, a cash disbursements journal and *purchase invoices*. In *King Crab*, unlike this case, the taxpayer *did not* maintain cash register tapes. The auditor in *King Crab* spot checked a single box of guest checks and found them out of chronological order. Based on this spot check and a lack of cash register tapes, the auditor determined that the records were inadequate. The Court concluded that the audit was arbitrary and capricious because the auditor had not made an adequate review of the records available to him to justify his conclusion that the records were inadequate (*Matter of King Crab Rest. v. Chu, supra*, 522 NYS2d, at 979). We

note that unlike petitioners here, the taxpayer in ***King Crab*** had source documents (guest checks) that could be compared with its other books and records, e.g., bank statements and purchase invoices. That is not the case here. The record in this case supports the conclusion that the books and records provided were reviewed by the auditor and only then found to be inadequate.

We also reject Karay's claim that their records were adequate because they had cash register tapes. Petitioners offered no evidence at hearing that would have permitted the auditor or this Tribunal to *verify* that the amounts shown on its register tapes were accurate. Indeed, there is no evidence from petitioners to show the quality of their register tapes, e.g., whether the tapes are dated, or whether they separately state the charges and the tax for each transaction. More importantly, there is no way for the auditor or this Tribunal to know whether every transaction represented by a guest check was recorded on petitioners' cash register because petitioners conscientiously destroyed every guest check.

As a result, we conclude that the method used by the Division to determine the sales tax liability of Karay was rational and petitioners failed to prove by clear and convincing evidence that the amount of tax assessed was incorrect.

Therefore, the determination of the Administrative Law Judge is affirmed.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Karay Restaurant Corporation, Christos Karayiannis, as officer of Karay Restaurant Corporation, John Karayiannis, as officer of Karay Restaurant Corporation and Peter Karayiannis, as officer of Karay Restaurant Corporation is denied;
2. The determination of the Administrative Law Judge is affirmed;

3. The petitions of Karay Restaurant Corporation, Christos Karayiannis, as officer of Karay Restaurant Corporation, John Karayiannis, as officer of Karay Restaurant Corporation and Peter Karayiannis, as officer of Karay Restaurant Corporation are denied; and

4. The notices of determination dated March 17, 1994 and April 27, 1994, except as modified (*see*, finding of fact "8" of the Administrative Law Judge's determination), are sustained.

DATED: Troy, New York
December 10, 1998

/s/Donald C. DeWitt

Donald C. DeWitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.

Joseph W. Pinto, Jr.
Commissioner