STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

RYKG, INC. :

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, 1998 through May 31, 2001. :

In the Matter of the Petition :

of :

HOWARD FRANK :

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, 1998 through May 31, 2001. :

DECISION
DTA NOS. 819983
AND 819984

Petitioners RYKG, Inc. and Howard Frank, 6 Spinnacker Court, Fort Salonga, New York 11768 filed an exception to the determination of the Administrative Law Judge issued on January 12, 2006. Petitioners appeared by Kestenbaum & Mark (Bernard S. Mark, Esq., of counsel) and Karen J. Tenenbaum, P.C. (Karen J. Tenenbaum, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Lori P. Antolick, Esq. and Osborne K. Jack, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on November 6, 2006 in New York, New York.

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

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioners have shown error in either the audit method or result.

II. Whether penalties imposed pursuant to Tax Law § 1145(a)(1)(i) and (vi) should be sustained.

FINDINGS OF FACT

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

After graduating in 1984 from Fairleigh Dickinson University with a degree in marketing, petitioner Howard Frank worked in retail stores, delis and pizza places. Then, for a number of years, he owned a deli in Westbury, New York, which he sold sometime prior to June 1994. On or about June 10, 1994, petitioner RYKG, Inc. ("RYKG" or "the corporation"), the S corporation owned equally by Mr. Frank and his wife, Pamela Frank, purchased a "going" fast food concession that operated a shopping mall fast food snack stand. Mr. Frank was president of RYKG.

RYKG operated this fast food snack stand in the Sunrise Mall, a two-level shopping mall containing three anchor stores and a total of approximately 150 stores, located in Massapequa, on Long Island, New York. The snack stand operated under the name "Snnnacks" or "Snacks" ("Snnnacks"). The stand, a free-standing kiosk, was located on the lower level of the mall in the middle of an open area near the entrance to Macy's. The kiosk was equipped with running water and a sink located behind the counter, as well as storage space for the food and beverage items available for sale. The 700-square-foot kiosk was surrounded by tables and chairs, belonging to Snnnacks, that seated approximately 20 people. During the period in issue, Sunrise Mall was open for business Monday through Saturday from 10:00 A.M. until 9:30 P.M. and on Sundays from 11:00 A.M. until 6:00 P.M. Snnnacks was open during the mall business hours.

Prior to the audit period, in addition to Snnnacks, a number of businesses, including a Roy Rogers Restaurant, a Nathan's and the Sunrise Deli, sold food and beverages in the Sunrise Mall. Over time, however, some of these businesses closed. On December 31, 1998, the Roy Rogers Restaurant, located on the lower level of the mall near Snnnacks, closed. On or about April 5, 1999, Nathan's, located in the middle of the mall, closed. On or about January 30, 2000, the Sunrise Deli, located on the upper level in the middle of the mall, closed.

During the period at issue, RYKG reported the following taxable sales:

Sales tax quarter ended	Taxable sales reported
Nov. 30, 1998 ("Nov-98")	$21,438.00
Feb. 28, 1999 ("Feb-99")	18,365.00
May 31, 1999 ("May-99")	16,988.00
Aug. 31, 1999 ("Aug-99")	15,340.00
Nov. 30, 1999 ("Nov-99")	20,322.00
Feb. 29, 2000 ("Feb-00")	18,111.00
May 31, 2000 ("May-00")	20,671.00
Aug. 31, 2000 ("Aug-00")	16,085.00
Nov. 30, 2000 ("Nov-00")	22,624.00
Feb. 28, 2001 ("Feb-01")	18,562.00

May 31, 2001 (“May-01”)	21,220.00
Total taxable sales reported	$209,726.00

It is noted that, with the exception of the quarter ending February 29, 2000, the amount reported as gross sales by the corporation on its sales and use tax returns filed for the audit period was the same as the amount reported as taxable sales on those returns.

On the U.S. Income Tax Return for an S Corporation (Form 1120S) that it filed for each of the years 1998 through 2002, RYKG reported its sales and gross profit as follows.

Year	Gross receipts or sales	Cost of goods sold	Gross profit
1998	$174,820.00	$35,629.00	$139,191.00
1999	$141,761.00	$30,202.00	$111,559.00
2000	$142,341.00	$33,437.00	$108,904.00
2001	$97,688.00	$23,966.00	$73,722.00
2002	$178,195.00	$25,740.00	$152,455.00

On the Federal corporate income tax returns that RYKG filed for the years 1998 through 2002, merchandise purchases in the amounts of $29,168.00, $32,605.00, $34,680.00, $15,320.00 and $12,308.00, respectively, were reported.

On or about August 1, 2001, the Division of Taxation assigned an auditor, Brian McCann, to conduct a sales tax field audit of RYKG for the period September 1, 1998 through May 31, 2001. The audit of RYKG originated because the gross sales reported on its sales tax returns were significantly less than the sales that were reported on its Federal income tax returns.

A review of the Tax Field Audit Record (“audit log”) indicates that, on September 5, 2001, the auditor contacted the corporation by telephone concerning the commencement of the sales tax field audit and spoke with Mr. Frank who referred the auditor to the corporation's representative, Ivan Goldstein, a certified public accountant. Further review of the audit log for that date indicates that the auditor was informed by Mr. Frank that the corporation operated a snack stand in the Sunrise Mall, which sold, among other things, hot dogs, pretzels and beverages.

An appointment letter dated September 10, 2001 advising that a sales tax field audit would commence on a date to be scheduled between the auditor and the taxpayer's representative was sent by the auditor to RYKG, Inc. c/o Ivan Goldstein. The letter requested that the corporation make available all of its books and records pertaining to its tax liability for the period under audit, September 1, 1998 through May 31, 2001, including journals, ledgers, sales invoices, purchase invoices, cash register tapes, Federal income tax returns and exemption certificates. Attached to the letter was a checklist of records to be presented for audit. The checklist restated the items listed in the letter and requested the following additional records: general ledger, cash receipts journal, cash disbursement journal, merchandise purchase invoices, expense purchase invoices, fixed asset purchase invoices, guest checks, financial statements, a power of attorney, bank statements, canceled checks and deposit slips.

On October 19, 2001, Mr. McCann received a packet of materials from Mr. Goldstein. The packet consisted of copies of the corporation's sales tax returns for the audit period, monthly bank statements for the entire audit period and a two-page summary of alleged product purchase information listing a total of eight products and suppliers, their alleged respective dollar amounts and the alleged total product purchase amounts for the audit period. According to these two pages, total alleged product purchases amounted to $10,215.00 for the period September 1, 1998 through December 31, 1998; $21,786.00 for the year 1999; $21,370.00 for the year 2000 and $6,066.00 for the period January 1, 2001 through May 31, 2001.

On October 25, 2001, the auditor initiated a telephone conversation with Mr. Goldstein during which they discussed the packet of documents previously supplied to the auditor and the auditor requested copies of the corporation's Federal income tax returns. During that telephone conversation, Mr. Goldstein informed the auditor that the taxpayer did not maintain a sales or cash receipts journal, cash register tapes or a day book. Rather, the taxpayer maintained "weekly or semi-weekly totals" on a computer with no backup. According to Mr. Goldstein, the products and dollar amounts listed on the two sheets were taken from purchase invoices and the purchases were paid for, at least in part, by cash from the cash registers.

On October 31, 2001, the auditor received copies of the corporation's Federal income tax returns for the years 1998 through 2000 from the representative. A reconciliation performed by the auditor indicated that the sales reported on the corporation's Federal income tax returns were higher than the sales reported on the corporation's sales tax returns. The auditor's review of the monthly bank statements indicated that the bank deposits had no correlation to sales.

Although a written request was made for all of the corporation's books and records pertaining to its sales and use tax liability for the audit period, the auditor did not receive any general ledgers, sales journals, day books, cash register tapes, guest checks, merchandise purchase invoices or expense purchase invoices for the audit period from the corporation's representative. After reviewing the records provided by the corporation, the auditor determined that these records were inadequate to determine the amount of Snnnacks' taxable sales.

On February 15, 2002, the auditor requested that a lunchtime field survey of Snnnacks be conducted by a Nassau District Office investigative aide. On or about March 6, 2002, investigative aide Lorin Kanton conducted a field survey of Snnnacks. During his field survey, Mr. Kanton made notes and diagrammed the area surrounding the snack stand, specifically identifying the following stores located nearby: Macy's, Nine West, Sterling Optical and The Limited. The auditor reviewed the notes and diagram with Mr. Kanton.

The Division decided to conduct a one-day observation test of Snnnacks to calculate the corporation's sales tax liability. By separate letters dated April 5, 2002, the auditor notified both Mr. Goldstein and Mr. Frank of the Division's decision to conduct an unannounced one-day observation of Snnnacks within the next six weeks. The audit log indicates that Mr. Goldstein responded by telephone on April 8, 2002, stating that he wanted to know the exact date on which the observation of Snnnacks would take place. It further indicates that the auditor informed Mr. Goldstein that the observation would take place within six weeks of April 5, 2002; however, the exact date could not be disclosed to Mr. Goldstein. The audit log also indicates that Mr. Goldstein strongly opposed the proposed unannounced observation. Mr. Goldstein did not suggest an alternate course of action to be taken to determine the corporation's sales tax liability.

After conferring with his team leader and section heads, the auditor selected Friday, April 26, 2002 as the date on which to conduct a one-day observation test of Snnnacks. On April 23, 2002, in preparation for the unannounced one-day observation test, Mr. McCann did an initial field visit to Snnnacks and noted in his audit log that the snack stand sold, among other things, sandwiches, soda, juice, iced tea, candy, hot dogs, hamburgers, popcorn and coffee. He also noted that the prices of blackboard special sandwiches ranged from $4.75 to $5.75 with an included small soda.

An unannounced one-day observation test was conducted at Snnnacks on April 26, 2002 by Mr. McCann and two other auditors from 10:20 A.M. until 9:30 P.M. when the mall closed. Before beginning their observation of Snnnacks, the auditors contacted mall security and management and explained why they were present in the mall on that date. Then, the auditors went down to the concession stand, identified themselves to the employees working at Snnnacks and commenced the observation at 10:20 A.M. Shortly thereafter, one of the employees called Mr. Frank at the Broadway Mall and he came to Snnnacks for a brief period of time in the afternoon. After the introductions, no further conversations took place between the auditors and either any of Snnnacks' employees or Mr. Frank during the remainder of the day.

The Massapequa and Farmingdale areas experienced rain, heavy at times, and gusting winds on Thursday, April 25, 2002. However, Friday, April 26, 2002, the date of the observation, was a regular seasonal day with no significant weather characteristics.

During the observation test, Mr. McCann observed three employees working at the Snnnacks kiosk at all times. He also observed that the night manager replaced the day manager at 5:00 P.M. Using the menu board displayed within the kiosk, customers would place their orders at the kiosk counter. Two cash registers were located within the kiosk, one on each end of the counter. At times during the observation test, the auditors observed sales being simultaneously rung up on the cash registers. During the observation test, Mr. McCann noted that a muffin delivery was made to Snnnacks and paid for in cash. Mr. McCann also observed that there was a McDonald's located within the mall, as well as a concession selling pizza.

Additionally, he observed that a food court was being constructed at the opposite end of the mall (from Snnnacks) on the upper level.

On the date of the observation test, Mr. McCann did not see a printed menu price list, only a menu board displayed within the snack stand. Neither Mr. Frank nor any of Snnnacks' employees working that day supplied Mr. McCann with a printed menu. During the course of the audit, the corporation did not provide Mr. McCann with any printed menus listing the sales prices of the food and beverage items available for sale at Snnnacks during the period September 1, 1998 through May 31, 2001. No cash register tapes were provided to the auditor for either the audit period or the date of the observation test.

In his observation worksheet notes, Mr. McCann identified some of the items sold by Snnnacks, along with their respective prices. A review of his observation notes indicates that, on the date of the observation test, Snnnacks had three "Lunch Specials (Blackboard)," i.e., tuna salad, chicken salad and egg salad, that included a small drink in the price. Mr. McCann further noted that Snnnacks sold, among other items, bottled water, hot popcorn and hot pretzels. His observation notes also identified the following "possible nontaxable" items for sale (if not consumed on Snnnacks' premises): a muffin, small chips, small cake, fruit salad by the pound, Nesquick chocolate milk, Snapple iced tea, a plain roll and Tropicana orange juice.

One of the auditors also recorded the prices of food and beverage items available for sale at Snnnacks from its menu board on the back of her first observation worksheet. A review of her notes concerning that menu board price list indicates that Snnnacks sold, among other things, hamburgers (with or without cheese), hot dogs, potato and spinach knishes, pretzels, popcorn, breakfast sandwiches, assorted sandwiches, chili, three sandwich "specials," soup, coffee, hot chocolate, soda and fresh fruit salad (½ lb. and 1 lb. sizes). The auditor noted that the menu board price list also included chips, candies, orange juice and chocolate milk.

Although Snnnacks had a small number of nontaxable items available for sale, Mr. McCann noted that it sold "very, very little" of these items on the day of the observation. He observed that when one of these nontaxable items was purchased, the customer sat down at a table to consume the item, therefore making the item taxable.

The record includes a total of eight observation worksheet pages on which the auditors recorded RYKG's sales that they observed between 10:20 A.M. and 9:30 P.M. on the date of the observation test, April 26, 2002, as well as notes about the snack stand, the items available for sale and the observation itself. During the observation test, the auditors did not record each taxable item sold. Rather, on the observation worksheets, the auditors itemized, on an hourly basis, the total taxable amount, if any, of each sale based on what they saw being sold and rung up on the registers by the employees, as well what the auditors heard the employees tell the customers was due. If a customer's order included the purchase of a Snapple iced tea for off-premises consumption, the cost of the Snapple was deducted from the total amount due and only the taxable amount of the sale was recorded on the observation worksheets. In instances where a customer's order included the purchase of a bag of chips for off-premises consumption, the auditors deducted the cost of the chips from the total amount due and recorded only the taxable amount of the sale on the observation worksheets.

Based upon the observation test results, Mr. McCann computed total taxable sales for April 26, 2002 to be $1,219.15. To determine the taxable sales for the quarter ending May 31, 2001, the auditor multiplied the $1,219.15 by 91 days[1] to arrive at $110,942.66. Since the observation test took place in April 2002 and the audit period ended on May 31, 2001, the auditor used the Bureau of Labor Statistics Data Consumer Price Index for food and beverages to adjust the quarterly taxable sales for inflation. After determining the rate of inflation for food and beverages between March 2001 and March 2002 to be 2.5%,[2] the auditor reduced the quarterly taxable sales of $110,942.66 by 2.5%, or $2,705.92[3] and determined audited taxable sales for the quarter ending May 31, 2001 to be $108,236.73. From the $108,236.73 in audited taxable sales for the quarter ending May 31, 2001, the auditor subtracted reported taxable sales for the quarter ending May 31, 2001 of $21,220.00 and determined audited additional taxable sales for the quarter ending May 31, 2001 to be $87,016.73 ($108,236.73 less $21,220.00 equals $87,016.73). To arrive at an error rate on reported sales of 410.07%, the auditor divided $87,016.73, the additional audited taxable sales for the quarter ending May 31, 2001, by $21,220.00, the reported taxable sales for the quarter ending May 31, 2001 ($87,016.73 divided by $21,220.00 equals 4.10069 rounded to 4.1007 or 410.07%). Then, the auditor multiplied the 410.07% error rate by the amount of taxable sales reported for the audit period and determined additional taxable sales in the amount of $860,023.42 for the period September 1, 1998 through May 31, 2001. He then multiplied the additional taxable sales determined to be due for the audit

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[1] The auditor subtracted 1 day for Easter from the 92 days in the quarter and arrived at 91 days.

[2] To determine the inflation rate of 2.5%, the auditor divided the Consumer Price Index ("CPI") for March 2002, 176.6, by the CPI for March 2001, 172.2 (176.6/172.2 equals 1.025 or 2.5%).

[3] To allow for inflation, the auditor first divided $110,942.65 by 1.025 and arrived at $108,236.73. Then, he subtracted $108,236.73 from $110,942.65, the taxable sales for the quarter ending May 31, 2002, to arrive at an allowance for inflation of $2,705.92.

period by the sales tax rate of 8.5% to arrive at additional sales tax due for the period September 1, 1998 through May 31, 2001 in the amount of $73,101.99.

A Statement of Proposed Audit Change for Sales and Use Tax (form AU-346) was issued to RYKG on May 2, 2002 that proposed additional tax due in the amount of $73,101.99, plus penalties and interest. The proposed penalties on the statement were computed pursuant to Tax Law § 1145(a)(1)(i) and (vi). A review of the audit log indicates that the auditor mailed the pertinent work papers and the statement to the corporation's representative.

Mr. Goldstein disagreed with the proposed audit change and filed a complaint against the Division. However, the corporation's representative canceled two scheduled conferences to discuss the audit findings.

Dennis Adelman was appointed as the corporation's representative on or about November 15, 2002. On November 22, 2002, the auditor, his team leader and Mr. Adelman had a conference at which the audit findings and the basis of the audit findings were discussed.

As a result of the conference and his audit experience, Mr. McCann revised his audit computations of the additional tax liability as follows. To determine the taxable sales for the quarter ending May 31, 2001, Mr. McCann divided the $1,219.15 in total taxable sales observed on April 26, 2002 by 0.1612, the estimated ratio of Friday's sales to total weekly sales,[4] to arrive at estimated weekly sales of $7,562.97. Then, the auditor multiplied the estimated weekly sales of $7,562.97 by the 13 weeks in the quarter to arrive at estimated quarterly taxable sales of $98,318.61. Next, using the 2.5% inflation rate, the auditor reduced the estimated quarterly

[4] To give weight to Friday being a busy sales day for Snnnacks, the auditor examined the sales from a prior audit of a similar fast food business, located at the Broadway Mall in Hicksville, New York, that he had conducted in May 2001. Based on his review of the information from that prior audit, Mr. McCann determined the estimated ratio of Friday's sales to total weekly sales to be 0.1612.

taxable sales by $2,398.01[5] and determined audited taxable sales for the quarter ending May 31, 2001 to be $95,920.60. From the $95,920.60 in audited taxable sales for the quarter ending May 31, 2001, the auditor subtracted reported taxable sales for the quarter ending May 31, 2001 of $21,220.00 and determined audited additional taxable sales for the quarter ending May 31, 2001 to be $74,700.60 ($95,920.60 less $21,220.00 equals $74,700.60). To arrive at an error rate on reported sales of 352.03%, the auditor divided $74,700.60, the additional audited taxable sales for the quarter ending May 31, 2001, by $21,220.00, the reported taxable sales for the quarter ending May 31, 2001 ($74,700.60 divided by $21,220.00 equals 3.52029 rounded to 3.5203 or 352.03%). Then, the auditor multiplied the 352.03% error rate by the amount of taxable sales for the audit period and determined additional taxable sales in the amount of $738,298.45 for the period September 1, 1998 through May 31, 2001. He then multiplied the additional taxable sales determined to be due for the audit period by the sales tax rate of 8.5% to arrive at additional sales tax due for the period September 1, 1998 through May 31, 2001 in the amount of $62,755.37.

On December 10, 2002, the Division issued two statements of proposed audit change to RYKG reflecting the auditor's revised computation of additional sales tax liability. The first statement proposed additional tax due in the amount of $56,405.80, plus penalties and interest, for the period September 1, 1998 through February 28, 2001. The second statement proposed additional tax due in the amount of $6,349.57, plus penalties and interest, for the period March 1, 2001 through May 31, 2001. On the same date, the Division also issued to RYKG an amnesty application for the Statement of Proposed Audit Change for the period September 1, 1998

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[5] The auditor divided $98,318.61 by 1.025 and arrived at $95,920.60. Then, he subtracted $95,920.60 from estimated taxable sales for the quarter of $98,318.61 to arrive at an allowance for inflation of $2,398.01.

through February 28, 2001. The audit log indicates that, on December 10, 2002, the auditor gave all the information to Mr. Adelman who was in the District Office on an unrelated matter.

After his receipt of the work papers and the two statements of proposed audit change, Mr. Adelman did not provide the auditor with any documentation pertaining to either the corporation's daily sales activity for the audit period or the auditor's estimate of these sales at any time prior to the issuance of the Notice of Determination. The audit log entry for January 10, 2003 indicates that, during a telephone conversation, Mr. Adelman informed the auditor that it was his belief that the corporation wanted to go through with amnesty; however, it was a matter of whether the payment could be made. A subsequent entry for January 23, 2003 indicates that Mr. Adelman called the auditor and, during that conversation, requested that the penalty be waived solely on the basis that it was the taxpayer's first audit. During that same telephone conversation, the auditor told Mr. Adelman that the vendor did not demonstrate reasonable cause and, then, transferred the phone call to the team leader's telephone number where the representative left a message. Subsequently, on January 28, 2003, while in the District Office on an unrelated matter, Mr. Adelman spoke with the auditor's team leader and explained that he was waiting to hear from the taxpayer (Mr. Frank). The audit log indicates that on March 7, 2003, the auditor spoke twice with Mr. Adelman by telephone and, during both conversations, Mr. Adelman stated that the taxpayer had informed him that he had filled out and filed the amnesty papers. Further review of the audit log reveals that the auditor did not have any further contact with the corporation's representative prior to the issuance of the Notice of Determination.

At no point after receiving the work papers and the related proposed audit changes, did either Mr. Adelman or the corporation's earlier representative, Mr. Goldstein, claim that the food and beverage items sold by Snnnacks on the date of the observation differed from those food and beverage items sold by it during the audit period.

Mr. Frank, on behalf of RYKG and as a responsible person of RYKG, executed a series of consents allowing the Division to assess tax for the period September 1, 1998 through May 31, 2000 at any time on or before June 20, 2003.

On May 5, 2003, the Division issued to RYKG, Inc., a Notice of Determination (Notice No. L-022327889-5) for sales and use taxes in the amount of $62,755.37, plus penalties of $25,102.15 and interest of $28,860.91, for a current balance due of $116,718.43.

On May 27, 2003, the Division also issued to Howard Frank, a Notice of Determination (Notice No. L-022329159-2) for sales and use taxes in the amount of $62,775.37, plus penalties of $25,102.15 and interest of $29,637.12, for a current balance due of $117,494.64.

Each of the statutory notices herein assessed penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi). Both statutory and omnibus penalties were assessed because the additional tax due is more than 25 percent of the audited tax due.

RYKG reported gross sales of $18,640.00, as well as taxable sales in the same amount, on the sales and use tax return that it filed for the quarter ending February 28, 2002.

Mr. Frank concedes that he is a responsible officer of RYKG, Inc.

On the Federal S-corporation income tax returns that it filed for the years 1998 through 2001, RYKG claimed a deduction for compensation of officers in the amount of $30,200.00 in the year 1998 and $31,200.00 in each of the years 1999 through 2001 and a deduction for salaries and wages (less employment credits) in the amount of $9,101.00, $19,467.00, $18,643.00 and $27,187.00 in the years 1998 through 2001, respectively. On these same corporate income tax returns, RYKG reported a deduction for rents in the amount of $74,627.00, $47,410.00, $54,762.00 and $74,627.00 in the years 1998 through 2001, respectively.

The corporation did not maintain a general ledger, a cash receipts book or a cash disbursements book. It also did not retain any cash register tapes. Each of Snnnacks' cash registers generated only a journal, not a receipt tape. These journals recorded the amount of the sales only, not a listing of each specific item sold. Even though the cash registers were closed out at the end of each work day, no record of the daily sales activity was retained or recorded in a day book. When a journal tape ran out, it was usually thrown away. The corporation did not keep a detailed record of specific items actually sold by Snnnacks during the audit period.

During the audit period, when product orders were delivered by the vendors, cash was taken out of a cash register to pay for the deliveries. The corporation retained product purchase invoices. Some of the invoices were kept at the kiosk and some were kept by both Mr. Frank and his father. None of the purchase invoices were provided to Mr. McCann prior to the issuance of the Notice of Determination. On limited occasions during the audit period, either Mr. Frank or his father would purchase mustard, ketchup or rolls at a grocery store, to supplement the purchases from the vendors. Although some receipts for grocery store purchases were kept, they were so faded that they were impossible to read. No grocery store receipts for purchases were provided to the auditor prior to the issuance of the notices of determination.

Until January 2000, Snnnacks gave mall employees a 25% mall employee discount on their food and beverage purchases. Snnnacks did not keep any record of the amounts of mall employee discounted sales that it made.

Petitioners submitted into evidence a copy of the Plainview Public School Calendar for the 2001 through 2002 school year obtained from the Plainview school system website.

The first store to open in the Sunrise Mall food court was a Wendy's, which opened in September 2002. In November 2002, Sbarro and Bourbon Street Café opened and in December 2002, Master Wok, Taco Bell and Nathan's opened.

Sometime in late 2003 Snnnacks ceased conducting business, the exact date of its closure is not part of the record. In or about December 2003, the Division commenced a sales tax reaudit of RYKG for the period June 1, 2001 through November 30, 2003.

The record includes summary data on the Sunrise Mall vehicle traffic volume counts for the seven-day period June 6, 2004 through June 12, 2004 conducted by a traffic and parking consulting firm for the Sunrise Mall. A review of this summary data indicates that a total of 15,940 vehicles entered the mall driveway on Friday, June 11, 2004 and a total of 95,677 vehicles entered the mall driveway during that 7-day period. Further review of this summary data indicates that traffic volume on Friday, June 11, 2004, accounted for 16.67% of the total traffic volume for the week.

Howard and Pamela Frank have two children, a daughter, Chloe, born on June 2, 1996 and a son, Robert, born on October 18, 1999. In January 1998, at 19 months of age, Chloe was diagnosed with autistic disorder. At that time, Chloe began receiving speech and occupational therapy and early learning special education at home and school. Chloe's parents and grandparents actively participated in her treatment and education. In February 2001, at 15 months of age, Robert began speech therapy. Sadly, in June 2001, at 20 months of age, Robert was diagnosed with an autistic spectrum disorder, and he immediately began receiving speech therapy and early learning special education. His parents and grandparents also actively participated in Robert's treatment and education. Both Chloe and Robert continue to receive therapy and special education for their developmental disabilities. Mr. and Mrs. Frank continue to devote their attention to their children's developmental needs.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In her determination, the Administrative Law Judge noted that the Division did make a proper request for books and records. However, the Administrative Law Judge determined that the books and records produced by petitioners were not adequate and that the Division was justified in resorting to an indirect audit method in order to estimate the corporation's sales tax liability. The Administrative Law Judge stated that the Division's use of an observation test as its audit methodology was reasonable and that the burden was placed upon the taxpayer to show that such audit method was unreasonable or that the results were unreasonably inaccurate. Since petitioners failed to demonstrate that the audit results were inaccurate or otherwise unreasonable, the Administrative Law Judge sustained the notices of determination issued to petitioners. Furthermore, in the absence of reasonable cause, the Administrative Law Judge sustained the penalties imposed herein.

ARGUMENTS ON EXCEPTION

Petitioners argue that the audit results were flawed in several respects. Petitioners contend that Snnnacks did have printed menus which were not even considered by the Division in conducting its audit. Petitioners state that at least 25% of their total sales were sold at a discounted employee rate which discount was not taken into account by the Division's auditor. Moreover, petitioners contend that during the audit period Snnnacks had much more competition than on the day of the observation test. Therefore, the sales on the date of the observation were much higher than actual sales made during the audit period.

Therefore, based on several factors as asserted by petitioners in their brief, they contend that the Division's observation test was not reliable and, thus, they urge that the audit was not reasonable. Additionally, petitioners assert that given extenuating personal circumstances, Mr. Frank was unable to give his full attention to the audit of RYKG and, as such, is entitled to an abatement of penalties in this case.

In opposition, the Division states that the use of an observation test method to estimate petitioner's sales was both justified and reasonable. The Division argues that petitioners have failed to prove by clear and convincing evidence that the audit method was flawed. Thus, the Division requests that the Administrative Law Judge's determination be sustained.

OPINION

We affirm the determination of the Administrative Law Judge.

There is no dispute that the Division properly requested and reviewed the books and records supplied by petitioners for the audit period. Clearly, the documents submitted by petitioners were not adequate to verify taxable sales. At this point, the Division was within its power to use an indirect audit method in order to estimate sales tax liability (***see***, ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576, 456 NYS2d 138). The issue presented to us is whether the observation test employed by the Division was reasonably calculated to reflect taxes due.

As set forth in her determination, the Administrative Law Judge stated that the use of an observation test has been upheld by the Courts (***see***, ***Matter of Del's Mini Deli v. Commissioner of Taxation & Fin.***, 205 AD2d 989, 613 NYS2d 967; ***Matter of Sarantopoulos v. Tax Appeals Tribunal***, 186 AD2d 878, 589 NYS2d 102; ***Matter of Vebol Edibles v. New York Tax Appeals Tribunal***, 162 AD2d 765, 577 NYS2d 678, ***lv denied*** 77 NY2d 803, 567 NYS2d 643; ***Matter of Club Marakesh v. Tax Commn. of State of New York***, 151 AD2d 908, 542 NYS2d 881, ***lv denied*** 74 NY2d 616, 550 NYS2d 276; ***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679).

Petitioners attempted to undercut the auditor's results by pointing to certain discrepancies they determined between the business of Snnnacks during the audit period as compared to the business of Snnnacks as observed by the auditor during the observation test. For example, petitioners state that during the audit period, they sold a limited number of items that were not sold on the date of the observation. Petitioners argue that written menus were available to customers which the auditor did not use in his observation test. Moreover, petitioners allege that the auditor should have made an adjustment for the fact that on the observation date, there was construction taking place in the mall and, as a result, the construction workers patronized Snnnacks, thus, inflating the amount of sales as compared to sales made during the audit period. Petitioners also reasoned that since the observation was conducted on a Friday, the sales were also higher since petitioners claim that Friday is a very busy day at the mall and that resulted in the observation date sales being higher than a normal day of sales during the audit period.

Additionally, petitioners asserted that sales were higher on the date of the observation because on that particular day a retail store located in the mall was having a Mother's Day sale which they argue directly reflected an increase in sales at Snnnacks.

All of petitioners' arguments are mere assertions without any supporting evidence to show that any adjustments should have been made to the audit results. The estimate methodology utilized by the Division must be reasonably calculated to reflect taxes due ***(see***, ***Matter of W.T. Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (***see***, ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Cinelli***, Tax Appeals Tribunal, September 14, 1989). It has been held that "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (***Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221). Without proof indicating that any adjustments are warranted, we see no need to adjust the Division's calculations in any respect.

The next issue deals with the penalties imposed pursuant to Tax Law § 1145(a)(1)(i) which are authorized for failure to pay tax. The abatement of penalties is allowed where the taxpayer demonstrates that the failure or delay to pay taxes was due to reasonable cause and not due to willful neglect. Although we sympathize with the personal extenuating circumstances surrounding Mr. Frank's children, it is undisputed that Mr. Frank had an extensive business background and had experience with running a business similar to that of Snnnacks. Yet, despite this experience, he failed to maintain basic books and records required of a business. Thus, petitioners have failed to demonstrate entitlement to an abatement of penalties. Therefore, we sustain the notices of determination issued to petitioners.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of RYKG, Inc. and Howard Frank is denied;

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

3. The petition of RYKG, Inc. and the petition of Howard Frank are denied; and

4. The Notices of Determination dated May 5, 2003 and May 27, 2003, respectively, are sustained.

DATED: Troy, New York
May 3, 2007

/s/Charles H. Nesbitt
Charles H. Nesbitt
President

/s/Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott
Robert J. McDermott
Commissioner