

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

GOT-A-LOT-A-DOUGH, 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 March 1, 1998 through :
February 28, 2001. :

DECISION
DTA NOS. 820112
AND 820113

In the Matter of the Petition :

of :

CATHERINE KUNCMAN :

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 March 1, 2000 through :
February 28, 2001. :

Petitioner Got-A-Lot-A-Dough, Inc., 4261 Austin Boulevard, Island Park, New York 11558 and petitioner Catherine Kuncman, 1147 E. Broadway, Hewlett, New York 11557, each filed an exception to the determination of the Administrative Law Judge issued on February 2, 2006. Petitioners appeared by Dennis H. Stamm, CPA. The Division of Taxation appeared by Mark F. Volk, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioners filed a letter brief in support of their exception. The Division of Taxation filed a letter brief in opposition and petitioners filed a letter brief in reply. Oral argument was not requested.

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

ISSUE

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.

FINDINGS OF FACT

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

Petitioner Got-A-Lot-A-Dough, Inc. ("the corporation") owned and operated two Dunkin' Donuts stores in Nassau County, New York, located at 4261 Austin Boulevard, Island Park, New York and 3151 Lawson Boulevard, Oceanside, New York.

The Austin Boulevard store was open 24 hours a day, 7 days a week and was in operation throughout the entire audit period. The Lawson Boulevard store was open from 6:00 A.M. to 9:00 P.M. daily. The corporation commenced operation of the Lawson Boulevard store in May 1999. The stores sold mostly coffee, doughnuts, bagels, muffins and sandwiches. The stores also sold juice, soft drinks and milk.

On June 9, 2000, the Division of Taxation ("Division") sent a letter to the corporation scheduling an appointment for June 26, 2000 on which to commence a sales and use tax field audit of the corporation's business for the period March 1, 1998 through February 28, 2000. The

Division's letter requested that all of the corporation's books and records pertaining to the stores for the audit period be available for review. Among the records specifically requested were the general ledger, cash receipts journal, Federal income tax returns, purchase invoices, sales invoices, guest checks, cash register tapes, bank statements, financial statements and exemption documents. The Division sent a second such appointment letter on July 20, 2000.

In response to the Division's request, the corporation produced income tax returns, sales tax returns, a 1999 general ledger, and about two months of 2000 daily sales summaries. The corporation produced no cash register tapes, sales invoices or other source records in response to the Division's request.

The Division deemed the records produced by the corporation in response to its request to be inadequate for the purpose of verifying taxable sales and, therefore, by letters dated November 20, 2000 and November 30, 2000 advised the corporation that an observation test of the corporation's sales would be conducted.

The Division conducted observation tests at the Austin Boulevard store on Monday, January 8, 2001 and at the Lawson Boulevard store on Thursday, January 11, 2001. Both tests were conducted from 6:00 A.M. to 6:00 P.M. and both were conducted by Division investigators and auditors. In conducting the tests, Division personnel recorded taxable sales on tally sheets. Nontaxable sales were not recorded. The tally sheets were then reviewed to confirm that the observed sales were taxable.

Total observed taxable sales at the Austin Boulevard store were \$684.69 for the 12-hour observation period. Taxable sales for the remaining hours of operation were estimated at 20

percent of taxable sales for the observation period or \$136.94. Total taxable sales for one day at Austin Boulevard, deemed a normal or regular day, were thus estimated to be \$821.36.

Total observed taxable sales at Lawson Boulevard were \$690.01 for the 12-hour period. The Division estimated taxable sales for the balance of the store's hours of operation to be one-sixth of taxable sales for the observation period, or \$115.00. Total taxable sales for a regular day at Lawson Boulevard were thus estimated to be \$805.01.

The Division then calculated the number of days in the audit period¹ for each store: 1,095 days for Austin Boulevard and 669 days for Lawson Boulevard. The Division determined that both stores had reduced sales on weekends, holidays and bad weather days. For Austin Boulevard, the Division calculated 156 weekend days, 30 bad weather days, and 24 holidays for a total of 210 reduced sales days. For Lawson Boulevard, the Division allowed 88 weekend days, 20 bad weather days, and 24 holidays for a total of 132 reduced sales days. After subtracting reduced sales days from total days, the Division determined 885 regular sales days for Austin Boulevard and 537 regular sales days for Lawson Boulevard.

The Division estimated daily sales on reduced sales days at Austin Boulevard at one-third of regular sales days or \$273.88. Reduced sales days at Lawson Boulevard were determined to be a quarter of regular sales or \$201.25.

The Division determined total taxable sales for the audit period at each location by multiplying regular day sales by the number of regular days in the audit period and adding to that

¹ The Division expanded the audit period to February 28, 2001. Thus the audit period for Austin Boulevard was 3 years and for Lawson Boulevard 22 months. The Division advised the corporation by letters dated April 6, 2001 and December 6, 2001 of the expanded period. The December 6 letter requested records to substantiate sales for the expanded period. The corporation produced no additional records in response to this request.

total the product of reduced day sales multiplied by the number of reduced sales days. Such calculations yielded total taxable sales for the audit period of \$784,654.74 at Austin Boulevard and \$458,856.65 at Lawson Boulevard.

Total taxable sales by the corporation of \$1,243,511.39 were then reduced by sales tax included of \$97,417.94 and reported taxable sales for the audit period of \$548,795.00 to reach additional taxable sales of \$597,298.45. The Division apportioned such additional taxable sales to the sales tax quarters comprising the audit period by applying an error rate of 108.8382 percent to reported taxable sales in each quarter. This error rate equals the ratio of additional taxable sales as determined on audit to reported taxable sales. The Division then applied the prevailing tax rate to determine additional tax due per quarter. The Division thus determined \$50,770.36 in additional tax due for the entire audit period.

On May 15, 2003, the Division issued to the corporation a Notice of Determination which asserted \$50,770.36 in additional sales tax due, plus interest, for the period March 1, 1998 through February 28, 2001.

On June 6, 2003 the Division issued to petitioner Catherine Kuncman a Notice of Determination which asserted \$16,798.59, plus interest, for the period March 1, 2000 through February 28, 2001. The notice advised this petitioner that the Division had determined that she was a corporate officer or a person responsible for the collection and payment of sales and use taxes due from the corporation and therefore personally liable for the sales and use taxes due from the corporation.

Petitioner Catherine Kuncman was an officer of the corporation during the relevant period. She does not contest her status as a corporate officer or person responsible for the collection and payment of sales and use taxes due from the corporation.

As noted previously, the observation tests recorded taxable sales only. Any nontaxable sales observed were not recorded. The Division's audit method and results did not rely in any way on a separate calculation of the corporation's nontaxable or gross sales.

The Division did not audit or compute gross sales on a quarterly basis. The audit did estimate total gross sales for the audit period using the corporation's reported gross receipts per its Federal income tax returns for 1998 and 1999. The 1999 reported gross receipts were used to estimate gross sales for 2000 and January and February 2001. The audit report indicates total audited gross sales for the audit period of \$2,728,792.00. The Division's auditor testified at hearing that the estimate of audited gross sales was done "for statistical purposes."

The corporation reported a total of \$1,742,038.00 in gross sales on its sales tax returns for the audit period. This total includes reported gross sales for eight of the twelve sales tax quarters in the audit period. The corporation did not report any gross sales on its returns filed for four of the quarters in the audit period.

For certain quarters of the audit period, audited taxable sales exceeded reported gross sales. Specifically, for the quarter ending May 31, 1998 the Division determined audited taxable sales of \$29,377.27 while the corporation reported \$25,868.00 in gross sales for the same period. For the quarter ending August 31, 1998, the Division determined \$225,787.48 while the corporation reported \$221,893.00 in gross sales for the same period. For the quarters ending November 30, 1998, February 28, 1999, August 31, 1999, November 30, 1999, August 31, 2000,

and November 30, 2000 audited taxable sales range from 85 percent of reported gross sales to 15 percent of reported gross sales.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

At the outset, the Administrative Law Judge noted that the Tax Law requires a vendor to maintain complete and accurate books and records regarding its sales tax liability. Upon request, such books and records must be made available for audit by the Division (*see*, Tax Law §§ 1138[a], 1135, 1142[5]). Specifically, the records required to be maintained must include a true copy of each sales slip, invoice, receipt, statement or memorandum (Tax Law § 1135). Where insufficient records are kept and it is not possible to conduct a complete audit, the amount of tax due shall be determined by the Division from such information as may be available. Where necessary, the tax may be estimated on the basis of external indices (Tax Law § 1138[a]), and when estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due. The burden is then on the taxpayer to prove, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable.

In this case, the Administrative Law Judge determined that the Division made clear and unequivocal written requests for books and records of the corporation's sales, and that the corporation failed to maintain or produce such records for audit. The Administrative Law Judge also found that the Division reasonably concluded that the corporation did not maintain books and records that were sufficient to verify its taxable sales for the audit period. Having established the insufficiency of the corporation's books and records, the Administrative Law Judge found that the Division properly resorted to one-day observation tests at each store

location to determine the corporation's taxable sales. The Administrative Law Judge noted that petitioners did not dispute either the absence of sales records or the Division's authority to resort to indirect audit methodologies in this case. As for the audit method employed by the Division, the Administrative Law Judge observed that the extrapolation of the results of a one-day observation test over a multi-year period to determine taxable sales has been consistently sustained. Accordingly, the Administrative Law Judge found the only issue for determination was whether petitioners have established that the amount of tax assessed was erroneous.

The Administrative Law Judge observed that in contesting the audit results, petitioners pointed to no flaws in the specific observation methodology, but rather to the "final numbers." Petitioners' challenge was premised on the fact that the Division did not specifically audit the corporation's gross sales. Therefore, petitioners state that the Division accepted the corporation's reported gross sales and, thus, for two of the quarters in issue the Division has illogically determined that taxable sales exceeded gross sales. Yet, for other quarters, petitioners pointed out that the taxable percentage of audited taxable sales to reported gross sales ranged widely. Petitioners asserted that such results made "no numerical sense" and that, therefore, the notices of determination should be rescinded.

The Administrative Law Judge found petitioners' argument without merit. First, the Administrative Law Judge noted that the record does not reflect that the Division accepted the corporation's reported gross sales. Accordingly, the Administrative Law Judge found that the correlation, or lack thereof, between audited taxable sales and reported gross sales is irrelevant and has no bearing on the validity of the audit or the audit results.

The Administrative Law Judge stated that the Division determined the corporation's sales tax liability using an observation test that observed and recorded taxable sales and extrapolated the test results over the audit period to reach audited taxable sales. Given this audit method, the Administrative Law Judge found it was not necessary to observe nontaxable sales or to estimate gross sales since the amount of nontaxable or gross sales would have no impact on the corporation's audited sales tax liability. The fact that the audit method did not include an estimate of gross sales, the Administrative Law Judge observed, cannot reasonably be construed as an acceptance of reported gross sales.

The Administrative Law Judge also found petitioners' contention to be logically flawed. For sales tax purposes, gross sales equal taxable sales plus nontaxable sales. Thus, generally, an increase in taxable sales necessarily results in an increase in gross sales.²

The Administrative Law Judge noted the fact that the Division did not accept the corporation's gross sales is also shown by its estimate of gross sales in the audit report. Such estimate, based on the corporation's gross receipts as reported on its 1998 and 1999 Federal income tax returns, totaled \$2,728,792.00. Gross sales as reported on the corporation's sales tax returns totaled \$1,742,038.00.

Finally, as to the validity of reported gross sales, the Administrative Law Judge pointed out that the corporation did not report gross sales for four of the twelve sales tax quarters in the audit period, and offered no source documentation of its actual gross sales.

The Administrative Law Judge noted that a review of the evidence in this matter reveals an error in the audit calculations. The Division determined on audit that the corporation's stores

²One caveat to this formulation: An increase in taxable sales will not increase gross sales where such increase results from a disallowance of nontaxable sales. However, such is not the case in the instant matter.

had reduced sales on weekends. A weekend, the Administrative Law Judge observed, is a two-day period. The Division appears to have allowed, however, only one reduced sales day per weekend. Specifically, the Division allowed 156 reduced sales weekend days for Austin Boulevard over a three-year audit period. The Administrative Law Judge noted that there are 312 weekend days in a three-year period. For Lawson Boulevard, the Division allowed 88 reduced sales weekend days over the 22-month period spanning May 1, 1999 through February 28, 2001. The Administrative Law Judge also noted there are 95 weekends and 190 weekend days in this period. Accordingly, the Administrative Law Judge directed the Division to recompute the subject assessments by allowing 312 total weekend days for the Austin Boulevard store and 190 total weekend days for the Lawson Boulevard store in its calculation of additional taxable sales.

ARGUMENTS ON EXCEPTION

Petitioners, on exception, argue that the Administrative Law Judge erred in finding that it was not necessary for the auditor to observe nontaxable sales or compute gross sales. Petitioners also find it illogical that the Administrative Law Judge determined that petitioners' audited taxable sales exceeded their reported gross sales for certain quarters.

Petitioners state that the Administrative Law Judge erred in finding that the audit method "is irrelevant and has no bearing on the validity of the audit or the audit results" (Exception, p. 1).

Petitioners state that the Administrative Law Judge found that the taxpayer offered no books for audit. Petitioners claim that in response to the Division's request for specific books

and records, they submitted their report of inputted computerized financial data, i.e., Quickbooks, from their computer entries.

OPINION

At the outset, we note petitioners' statement that the Administrative Law Judge found that the audit method "is irrelevant and has no bearing on the validity of the audit or the audit results." This misstates the conclusion made by the Administrative Law Judge. Petitioners' argument was that the Division had accepted the corporation's reported gross sales. In response, the Administrative Law Judge stated that the record did not support the conclusion that the Division accepted the corporation's reported gross sales. Therefore, the Administrative Law Judge reasoned that the correlation or lack thereof between audited taxable sales and petitioners' reported gross sales is irrelevant and has no bearing on the validity of the audit. We agree.

We next address petitioners' claim that they provided some of their financial information in the form of Quickbooks to the auditor, which they imply should have been sufficient for audit purposes. As the Administrative Law Judge noted, however, a vendor is required to maintain accurate, complete and verifiable books and records and provide such records for audit upon request of the Division (*see*, Tax Law §§ 1138[a], 1135, 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained shall include a true copy of each sales slip, invoice, receipt, statement or memorandum (*see*, Tax Law § 1135).

Since petitioners produced no sales slips, cash register tapes or other source documents showing the corporation's sales activity, the record supports the conclusion that petitioners' books and records were inadequate for a verifiable, detailed audit. Where a taxpayer's records

are inadequate for a complete audit, “the amount of tax due shall be determined . . . from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .” (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41). 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, 2 L Ed 2d 75) and exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025). The record reflects that petitioners did not dispute the absence of sales records or the Division’s authority to resort to indirect audit methods.

The Division properly resorted to an observation test for each business location and properly extrapolated the results of those observation tests over a multi-year audit period to arrive at additional taxable sales (*see, Matter of Marte*, Tax Appeals Tribunal, August 5, 2004). As the Administrative Law Judge stated, “*Given this audit method*, it was not necessary to observe nontaxable sales or to estimate gross sales since the amount of nontaxable or gross sales would have no impact on the corporation’s sales tax liability” (Determination, conclusion of law “C,” emphasis added). The Administrative Law Judge observed that the fact that the audit method selected did not estimate gross sales could not be construed as the Division’s agreement with gross sales as reported by the corporation. We agree.

Having determined that the Division was entitled to resort to an indirect audit method, the burden was on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*see, Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451). We find that petitioners failed to carry their burden of proof in either regard.

However, the Administrative Law Judge determined that the Division made a calculation error in its audit by failing to give the corporation's two locations the proper credit for reduced sales on weekend days.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exceptions of Got-A-Lot-A-Dough, Inc. and Catherine Kuncman are denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Got-A-Lot-A-Dough, Inc. and Catherine Kuncman are granted to the extent indicated in conclusion of law "D" of the Administrative Law Judge's determination, but are otherwise denied; and
4. The Division of Taxation is directed to modify the notices of determination dated May 15, 2003 and June 6, 2003 in accordance with paragraph "3" above and, as modified, the notices are sustained.

DATED: Troy, New York
November 16, 2006

/s/Charles H. Nesbitt

Charles H. Nesbitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Robert J. McDermott

Robert J. McDermott
Commissioner