STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petitions	:	
of	:	
RACCAGNA FOODS, INC. AND GRACE RACCAGNA	:	DECISION DTA NOs. 820548 and 820558
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 2000 through November 30, 2003.	:	

The Division of Taxation filed an exception to the determination of the Administrative Law Judge issued on July 31, 2008 with respect to the petitions of Raccagna Foods, Inc. and Grace Raccagna. Petitioners appeared by Barry Leibowicz, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert A. Maslyn, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioners filed a brief in opposition. The Division of Taxation filed a reply brief. Oral argument, at the request of the Division of Taxation, was heard on October 14, 2009 in Troy, New York.

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

ISSUES

I. Whether the Division of Taxation was entitled to rely on external indices for a calculation of petitioners' tax liability for the audit period.

II. Whether the audit method employed by the Division of Taxation was reasonably calculated to reflect petitioners' tax liability.

III. Whether Grace Raccagna was a person responsible for the collection and payment of sales and use taxes on behalf of Raccagna Foods, Inc., within the meaning and intent of Tax Law § 1131(1) and § 1133(c), and is, therefore, personally liable for payment of the taxes, penalties and interest due from the corporation.

IV. Whether penalties were properly imposed.

V. Whether the submission by the Division of Taxation of schedules and computations with its post-hearing brief were properly excluded from the record by the Administrative Law Judge.

FINDINGS OF FACT

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

Petitioner, Raccagna Foods Inc. ("Raccagna") owned and operated the Italian Buffet Restaurant located at 160 Adams Avenue, Hauppauge, New York, within an industrial park. Raccagna, incorporated on October 16, 2000, purchased the business from GCAGCA, Inc. ("GCAGCA") on December 26, 2000. The stockholders of GCAGCA and Raccagna were not identical. Raccagna offered an Italian hot and cold buffet (sold by the pound), pizza, heroes, and calzones to either eat in or take out. It also offered a catering menu for home and office parties, consisting of pasta and seafood items, and various entrees.

On July 28, 2003, the Division of Taxation ("Division") assigned an experienced auditor, Robert Lawrence, to conduct a sales and use tax field audit of Raccagna for the period December 1, 2000 through May 31, 2003. Petitioner was selected for audit based upon the recommendation of the Division's auditor assigned to audit the previous owner of the business. Mr. Lawrence's handwritten notes, dated July 28, 2003, in Raccagna's Tax Field Audit Record (audit log)

indicate that the first waiver of the period of limitations on assessment was due by March 20, 2004.[1]

The Division's auditor sent an appointment letter to Raccagna, dated August 4, 2003, which stated that its sales and use tax records for the period December 1, 2000 through May 31, 2003 had been scheduled for a field audit beginning September 9, 2003 at Raccagna's office. The letter further advised that all books and records pertaining to Raccagna's sales and use tax liability for the audit period must be available on the appointment date, and a "Records Requested List," containing a "detailed list of all records required to be available for audit on the appointment date," was attached to the letter. Among the records specifically requested in the Records Requested List were the general ledger, cash receipts journal, federal income tax returns, sales tax returns, purchase invoices, sales invoices, bank statements, financial statements and exemption documents.

On August 6, 2003, the auditor received a telephone call from Raccagna's accountant, Jay Oher, CPA, who confirmed the September 9, 2003 appointment at his firm's offices. A power of attorney appointing Mr. Oher, State Tax Consulting, Inc., to represent Raccagna was executed by Grace Raccagna, President, on August 6, 2003, and was submitted to the auditor.

A copy of an anonymous letter, dated April 11, 2001, alleging that the Italian Buffet Restaurant was incorrectly charging sales tax on food purchases (i.e., a squeal letter) was included in the case file when it was initially assigned to the auditor. On September 2, 2003, the auditor had lunch at the Italian Buffet and received a cash register receipt for his food and beverage purchase, which items he consumed on the premises. Subsequently, the auditor

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[1] A waiver for the period December 1, 2000 through February 28, 2001, the first quarter in the audit period, was due because the sales and use tax return for that quarter was timely filed.

attached this cash register receipt to the copy of the squeal letter in his file, and noted in the file that the correct amount of sales tax was charged. At the suggestion of his supervisor, approximately two weeks after his September 2nd lunch visit, the auditor inserted a reference to the lunch visit into the audit log, noting that he "went to business - very busy." During his September 2, 2003 lunch at the premises, the auditor did not obtain a take-out menu. The auditor's food and beverage purchase was properly reflected on Raccagna's master cash register tape for September 2, 2003.

On September 9, 2003, a field audit appointment was conducted at Mr. Oher's office. Documents provided by Mr. Oher for review by the auditor on that date were placed in the conference room used by the auditor to conduct his initial review of the corporation's records. The auditor did not inventory the records provided for his review by Mr. Oher at this field audit appointment. Rather, the auditor transcribed from the corporation's detailed general ledger information concerning sales for the months ending December 31, 2000 through April 30, 2003, sales tax payable for the quarters ending February 28, 2001 through February 28, 2003, purchases and a detail of the purchases by vendor for the months ending December 31, 2000 through May 31, 2003. The auditor also transcribed information about deposits from the corporation's Chase checking account split-month bank statements for the months ending December 31, 2000 through April 30, 2003. Among the records placed in the conference room for the auditor's review was a garbage bag of purchase invoices. Mr. Lawrence did not review the contents of this bag because he was unaware of its existence during that field audit appointment.

At the September 9, 2003 audit appointment, the auditor and Mr. Oher discussed Raccagna's records, which Mr. Oher claimed were adequate. During their discussion, the auditor requested the corporation's daybook, and Mr. Oher responded that there was no daybook. The

auditor was given unsigned copies of the corporation's federal income tax returns for an S corporation (forms 1120S) for the years 2001 and 2002 to take with him at the end of the audit appointment. A review of the audit log indicates that the next audit appointment was scheduled for December 11, 2003. The auditor did not make any notations concerning cash register tapes in his handwritten field audit visit notes or in his handwritten audit log entry concerning the September 9, 2003 field audit appointment.

On December 2, 2003, Mr. Oher called the auditor and cancelled the December 11, 2003 field audit appointment because he had a formal hearing at the Division of Tax Appeals in Troy, New York. A new audit appointment was not scheduled during that telephone call.

Subsequently, the auditor was advised of the bulk sale of Raccagna's business in a memo from the Division's desk audit section on December 31, 2003. This memo further advised that based upon the date of sale provided on the Bulk Sale Notification, "the assessment for any additional taxes determined to be due on field audit of [Raccagna] must be posted on [the case tracking system] by 2/17/2004," in order for desk audit to timely assess the purchaser as the associated responsible person. On January 2, 2004, the auditor received an e-mail reminder from desk audit that the field audit results were needed by February 17, 2004 in order to timely assess the purchaser.

Upon receiving notification of the bulk sale, the auditor called Mr. Oher's office on December 31, 2003 and left a message. The auditor also prepared an appointment letter dated December 31, 2003, in which he advised the corporation's representative that the audit period was being expanded to include the corporation's sales and use tax records for the subsequent updated period June 1, 2003 through November 30, 2003 and that a field audit to review the additional records was scheduled for January 15, 2004 at Raccagna's offices. This letter further

advised that, in addition to the records previously requested for audit, all books and records pertaining to the sales and use tax liability for the updated audit period must be available on the appointment date, and a Records Requested List was attached to the letter. This list for the amended audit period December 1, 2000 through November 30, 2003 contained a detailed list of the same records requested for the original audit period. Although the auditor addressed this letter to Mr. Oher's Forest Hills office, the United States Postal Service failed to deliver this appointment letter to him, and it was returned to the Division's Suffolk District Office on January 14, 2004. The auditor failed to note the return of this appointment letter as undeliverable in his audit log.

On January 5, 2004, the auditor reviewed the audit results of the previous owner, which were based upon outside observations. The auditor used the results of that prior audit to calculate Raccagna's taxable sales for the period December 1, 2000 through November 30, 2003. In the audit of the previous owner, the Division assessed sales tax in the amount of $214,534.00 on additional taxable sales of $2,923,806.00 for the period December 1, 1997 through November 30, 2000, a total of 12 quarters. Subsequently, the assessment was reduced by $35,755.69, to reflect that the restaurant was open only five days per week rather than six days per week as presumed in the audit determination. Since there were 12 quarters in each of the audit periods, Mr. Lawrence divided the reduction in tax in the prior audit ($35,755.69) by the tax rate at the time (8.25%), which resulted in a reduction in the amount of $433,402.30 to taxable sales. He then subtracted that amount from the $2,923,806.00 in taxable sales determined on the prior audit of the former owner and arrived at net taxable sales of $2,490,403.70 for the 12-quarter audit period. Next, he divided the net taxable sales, $2,490,403.70, by the 12 quarters and computed taxable sales per quarter in the amount of $207,533.64, which amount was used by the auditor as

Raccagna's estimated quarterly taxable sales. For each of the 12 quarters in the subject audit period, the auditor compared the estimated quarterly taxable sales to the reported quarterly taxable sales to calculate additional taxable sales. This amount was then multiplied by the tax rate in effect at the time to arrive at additional tax due in each quarter.

On January 8, 2004, Raccagna's representative called the auditor and stated that the corporation had adequate records and a daybook, which he would provide to the auditor at a meeting scheduled for February 6, 2004. During that telephone conversation, the representative and the auditor discussed the bulk sale of Raccagna's business, but the auditor neither requested any waiver of the period of limitations, nor asked for information about the purchaser.

On January 20, 2004, the auditor prepared the case tracking system upload of the assessment and issued to Raccagna a Statement of Proposed Audit Change for Sales and Use Tax for the period December 1, 2000 through November 30, 2003 asserting tax due in the amount of $162,610.67 plus penalty and interest. The proposed penalties were computed pursuant to Tax Law § 1145(a)(1)(i) and (vi). The auditor sent the statement and two pages of work papers to petitioner's representative on January 21, 2004 by certified mail. The auditor also included an undated memo addressed to Mr. Oher, which stated:

> The enclosed Au-346 [sic] is based on information available to date. Information presented and examined at the next appointment scheduled for 2/6/04, may result in adjustments to the proposed tax due. Considering the limited documentation presented thus far, might I suggest that all detailed sales records are [sic] made available on this date. This would entail, but not be limited to, all cash register tapes and daybooks for the audit period (12/01/00 - 11/30/03).

The first page of the included work papers is merely a breakdown of the estimated tax due in each of the quarters ending between February 28, 2001 and November 30, 2003. The second

page entitled, "x-050447927, notes from prior audit, assessment # L019094631," contains limited details of a computation of quarterly taxable sales.

The auditor prepared an appointment letter dated January 20, 2004, advising the corporation's representative that the audit period was being expanded to include sales and use tax records for the period June 1, 2003 through November 30, 2003 and that a field audit to review the additional records was scheduled for February 6, 2004 at Raccagna's offices. This letter further advised that, in addition to the records previously requested for audit, all books and records pertaining to the sales and use tax liability for the updated audit period must be available on the appointment date. A detailed Records Requested List was attached to the letter. The records specifically requested on this list for the amended audit period December 1, 2000 through November 30, 2003 did not include cash register tapes or daybooks. Instead, the list contained a detailed list of the same records requested for the original audit period by the initial appointment letter dated August 4, 2003. This letter was sent by certified mail to Mr. Oher.

In a letter to the auditor dated February 2, 2004, Mr. Oher expressed surprise at the issuance of the statement of proposed audit change when an audit appointment was scheduled for February 6, 2004, and petitioners' representative had already provided all of the documentation that the auditor requested. Mr. Oher stated that he needed more time to compile the appropriate data, i.e., cash register tapes and data for the extended audit period, because "now and out of the blue for the very first time you request cash register tapes" and "[a]dditionally, you now seek updated records for an additional time frame." He further stated that the additional time necessary to respond to the new expanded request required putting off the audit appointment scheduled for February 6, 2004 until early March since the "documentation you now seek is quite voluminous in nature." In addition, Mr. Oher requested that the statement of proposed audit

change be withdrawn because it was based on flawed assumptions and was premature in nature. The sales tax section of the Division's Suffolk District Office received this letter on February 4, 2004.

On February 3, 2004, petitioners' representative called the auditor and cancelled the February 6, 2004 appointment because he needed time to compile the additional requested books and records, including cash register tapes, in a manner that would allow the auditor to efficiently review them. During that telephone conversation, the February 6, 2004 audit appointment was rescheduled for March 3, 2004. The auditor added officer information to the upload for assessment on February 3, 2004, and the auditor's team leader released the upload for assessment on February 6, 2004. Subsequently, on February 9, 2004, the auditor issued an appointment letter to Raccagna's representative confirming the scheduled field audit, beginning March 3, 2004, of the corporation's sales and use tax records for the audit period December 1, 2000 through November 30, 2003. This letter further advised that all books and records pertaining to the sales and use tax liability for the audit period must be available on the appointment date. The Records Requested List attached to this letter contained a detailed list of the same records requested by the appointment letter dated January 20, 2004.

In anticipation of his March 3, 2004 audit appointment with Mr. Lawrence, Mr. Oher obtained the documentation requested by the auditor for the updated audit period, including, among other things, Raccagna's daybook and cash register tapes organized by month and year.

On February 9, 2004, the auditor notified the Division's desk audit section by e-mail that Raccagna's assessment would be issued shortly. The Division issued a Notice of Determination to Raccagna Foods, Inc., dated February 19, 2004, asserting additional sales and use taxes due in the amount of $162,610.67 for the period December 1, 2000 through November 30, 2003, plus

interest in the amount of $36,079.64 and penalty in the amount of $55,114.39, for a balance due of $253,804.70. On March 12, 2004, the Division issued a Notice of Determination against Grace Raccagna, as an officer or responsible person of Raccagna Foods, Inc., asserting sales and use tax due of $162,610.67 for the period December 1, 2000 through November 30, 2003 plus penalty of $56,097.37 and interest of $37,686.18 for a balance due of $256,394.22. Each of the statutory notices assessed penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi).

P & L Nanan Corp. purchased Raccagna's business on December 3, 2003, and notified the Division of such bulk sale purchase on December 8, 2003. The Division also timely assessed P & L Nanan Corp. as the bulk sale purchaser pursuant to Tax Law § 1141(c).

On March 1, 2004, Raccagna's representative called the auditor and cancelled the March 3, 2003 audit appointment. Subsequently, on March 2, 2004, the auditor received a letter dated February 24, 2004 from Raccagna's representative cancelling the March 3, 2004 meeting. This letter further stated that the Raccagna matter would proceed to the Bureau of Conciliation and Mediation Services.

Raccagna operated as a cash business and used cash register tapes rather than sales invoices for its sales transactions. As such, the auditor knew he was supposed to ask for cash register tapes specifically and separately from any request for sales invoices. The initial appointment letter to Raccagna, dated August 4, 2003, was generated based upon information selected by the auditor and entered into the Division's computer system. Because he failed to select cash business, the detailed records requested in the August 4, 2003 appointment letter did not include cash register tapes. The auditor never corrected his mistake, and all subsequent audit appointment letters failed to include a specific and separate request for cash register tapes.

The auditor prepared a Tax Field Audit Report (audit report) for Raccagna for the audit period December 1, 2000 through November 30, 2003. The report states that a daybook and other detailed sales records were requested on August 5, 2003 and December 31, 2003 but were not made available. The report also states that waivers of the period of limitations were not necessary because "there were no periods due to expire." In the additional information section of the audit report, the auditor states that he compared Raccagna's gross sales per its books to sales on its sales tax returns and federal income tax returns and found the sales "were in basic agreement."

At the hearing, the auditor admitted that his audit report contained numerous erroneous or misleading entries including, among other things, dates that requests for records were made, specific records requested, and dates on which statutory periods were due to expire.

On page 4 of the audit report labeled "Section 1 - Review of Sales Records," part of the narrative was altered and deleted by the auditor's supervisor after it was submitted to him by the auditor. The supervisor's alteration is visible only on the original of the audit report. At the hearing, the auditor confirmed that his supervisor did not personally participate in this audit.

In making his determination to assess Ms. Raccagna as a responsible person, the auditor reviewed the Division's taxpayer identification database and the power of attorney appointing Mr. Oher to represent Raccagna in the audit. The auditor never contacted Ms. Raccagna regarding her role, if any, in the business. He also did not make any inquiries of Mr. Oher regarding Ms. Raccagna's role, if any, in the business. The auditor prepared a Responsible Person Questionnaire for Ms. Raccagna on March 15, 2004 because it was a form needed to close out the file. At the hearing, the auditor was unable to identify the source of the information contained in the Division's taxpayer identification database.

At the hearing, the auditor admitted that the Notice of Determination was issued to Raccagna on February 19, 2004 because he did not want to let the period of limitations on assessment expire against the purchaser and he could not assess the purchaser without assessing Raccagna.

The record in this matter closed at the conclusion of the consolidated hearing on April 30, 2007. On December 5, 2007, along with its brief, the Division submitted six documents. The first three of these documents bore the heading "receipts, sales and sales tax per cash register tapes" and the date "08/06/2007," and the fourth document bore the heading "sales per daysheets" and the date "08/06/2007." The remaining two documents were copies of documents already in evidence as part of the Division's Exhibit H. Since the record in this matter closed on April 30, 2007, the first four documents, each dated "08/06/2007," were returned to the Division of Taxation with an explanation that no evidence could be submitted after the record was closed (***see***, ***Matter of Saddlemire***, Tax Appeals Tribunal, June 14, 2001).

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In her determination, the Administrative Law Judge recited relevant provisions of the Tax Law and applicable case law, which outlined the prerequisites necessary to allow the Division to use external indices to estimate a taxpayer's liability for sales and use tax. Specifically, the Administrative Law Judge noted that the Division was required to first request, and then thoroughly examine, a taxpayer's books and records for the entire period of the assessment to determine if they were so insufficient as to make it virtually impossible to verify taxable sales and conduct a complete audit.

The Administrative Law Judge found that the Division failed to make a request for the corporation's cash register tapes for the audit period before it resorted to external indices to

estimate the tax due. The Administrative Law Judge found that the evidence demonstrated that the Division's first request to review cash register tapes for the audit period was contained in an undated memo that accompanied the Statement of Proposed Audit Change for Sales and Use Tax issued to Raccagna on January 20, 2004. The Administrative Law Judge noted that, at the same time that cash register tapes were being requested, the Division had already prepared a statement of proposed audit change based on external indices.

Subsequent to the Statement of Proposed Audit Change, the Division issued a Notice of Determination to Raccagna on February 19, 2004 and a Notice of Determination to Grace Raccagna on March 12, 2004 assessing sales and use tax based on external indices.

The Administrative Law Judge concluded that the Division's resort to external indices (i.e., the estimation of petitioners' tax liability by resort to the audit of the previous owner of the business) without first requesting the taxpayer's books and records for the entire audit period and then reviewing them was improper. The Administrative Law Judge stated that:

> Given the erroneous and misleading statements in the audit report regarding the specific records requested and the dates of such requests, it is clear that the auditor was fully aware that he could not resort to external indices without making an adequate request for Raccagna's books and records for the entire audit period (Conclusion of Law "C", Determination of the Administrative Law Judge).

As a result, the Administrative Law Judge cancelled the Notices of Determination issued to petitioners and held that the remaining issues raised by petitioners (i.e., the status of Grace Raccagna as a responsible person for the collection of sales tax and the issue of penalty) were moot.

ARGUMENTS ON EXCEPTION

On exception, the Division argues that the Administrative Law Judge incorrectly determined that the Division failed to make a sufficient request for the cash register receipts from

petitioners' business. The Division maintains that its written request of August 4, 2003 that petitioners furnish "all sales invoices" as well as "all books and records pertaining to the sales and use tax liability" was a sufficient request for petitioner's records and that the records supplied were not adequate for the Division to conduct an audit. The Division asserts that subsequent to August 4, 2003, the auditor made oral and telephonic requests for cash register tapes. Further, on January 20, 2004, the auditor made a written request for such tapes. However, no source sales documents were ever provided at the initial appointment and petitioners' representative cancelled all later appointments without providing any additional documents. Therefore, the Division was justified in resorting to external indices in order to estimate petitioners' tax liability.

The Division argues that even if the cash register tapes had been provided, in the absence of individual guest checks, the tapes would be insufficient to verify the accuracy of sales transactions. Therefore, it is irrelevant that the Division did not specifically request cash register tapes because the Division requested sales invoices, which were not provided.

The Division disagrees with the Administrative Law Judge's finding that petitioners were not afforded sufficient opportunity to provide cash register tapes on audit. Rather, the Division asserts that petitioners were afforded opportunities during the audit, both prior to and subsequent to the issuance of the Notices of Determination, to provide additional books and records, and that despite repeated requests, petitioners refused to provide further documentation.

The Division argues that it need not specifically request cash register tapes when it makes a request for "all sales invoices" and "sales records of any kind."

The Division points out that simply because an assessment had been issued, petitioners were not justified in refusing to provide its books and records. The Division advised petitioners'

representative that the assessment could be adjusted upon presentation of further information. The Division believes that it was justified in issuing an assessment when it did in order to "preserve its right to issue a bulk sale purchaser assessment" (Division's brief in support, p. 22). Further, the Division asserts that in a post-hearing review of a portion of the cash register tapes that were provided at the hearing, they were found by the Division to be "so riddled with inaccuracies as to make them unreliable" (Division's brief in support, p. 23). The Division argues that it was authorized by the Administrative Law Judge to review, tally and prepare handwritten summaries of the cash register tapes, and the Administrative Law Judge's refusal to allow the Division's compilation into the record was improper.

Finally, the Division maintains that its audit methodology was reasonable and that petitioners failed to prove that the audit assumptions were flawed.

In opposition, petitioners argue that, when a request is not made for the taxpayer to produce books and records, an alternative estimation method may not be used in the audit. Instead, if a taxpayer's books and records are adequate, the taxpayer is entitled to have an actual audit rather than an estimated audit. Petitioners maintain that proof, gathered after an assessment is issued, does not eliminate the requirement that an assessment must be based on information available at the time the notice is issued.

Petitioners agree with the determination of the Administrative Law Judge that the Division's resort to external indices was improper. Further, petitioners agree with the Administrative Law Judge that the Division did not make a request for the corporation's cash register tapes prior to resorting to external indices to estimate the tax. In fact, petitioners maintain that the Division issued its statement of proposed audit adjustment prior to petitioners' receipt of a single request to produce cash register tapes.

Petitioners assert that cash register tapes are not synonymous with sales invoices. Petitioners point out that the Division's regulations (***see***, 20 NYCRR 533.2[b][1][i] and [iii]) specifically refer to sales invoices and cash register tapes separately. Petitioners further assert that the auditor knew that petitioners used cash register tapes and not sales invoices based on his own visits to petitioners' place of business. Petitioners maintain that the auditor admitted that he should have used a different form to request records, which would have specifically listed cash register tapes among the records to be produced by petitioners.

Petitioners argue that they did not fail to produce adequate records, but rather, that the Division failed to allow petitioners adequate time to do so prior to issuing its assessments. Petitioners note that although the auditor scheduled an appointment with petitioners' representative in March 2004 to review additional records, the Division issued an assessment in February 2004 based on an observation conducted during a prior audit. Petitioners maintain that the cancellation of the March appointment by petitioners' representative was not a refusal to produce records but a reaction to the auditor's actions in issuing the Notice of Determination.

Petitioners disagree with the Division's position that even though a Notice of Determination had been issued, the audit was not closed. Petitioners assert that once the Notice of Determination was issued, they proceeded to contest the assessment as allowed by the Tax Law, for the failure to timely protest a Notice of Determination makes it binding on a taxpayer. Petitioners acknowledge that the Division has the authority to grant a courtesy conference once appeal rights have terminated. However, petitioners believe that this does not mean that the Division has the right to engage in post-assessment audit activities, and that to do so would deprive taxpayers of due process.

Petitioners maintain that additional information gathered post-assessment cannot be used to bolster a defective assessment, even if the information establishes that the amount of tax assessed was reasonable. Further, petitioners argue that proof gathered after an assessment is issued does not eliminate the requirement that a request for books and records be made prior to resorting to external indices. Petitioners assert, therefore, that the Division's evidence, which it attempted to submit post-hearing, as well as all evidence submitted (which was gathered post-assessment) is inadmissible. Petitioners point out that the cash register tapes admitted into evidence were admitted solely for the purpose of demonstrating that they were the tapes to have been delivered to the Division's auditor at the March 3, 2004 appointment, and that they were not admitted on the basis of their content.

Petitioners argue that even if, arguendo, the Division was entitled to use external indices to estimate petitioners' tax liability, the method chosen was defective. The observation of the business was made when it was owned by petitioners' predecessor and when the business was operated differently.

Petitioners argue that the Division had no evidence that Grace Raccagna was a person responsible for the reporting and collection of sales tax, in that the auditor had no contact with Grace Raccagna and he filled out a responsible person questionnaire concerning her role in petitioners' business with absolutely no knowledge as to whether his answers were correct or not.

Petitioners assert that due to the auditor's actions, and the errors contained in his audit file, the assessment cannot be sustained.

OPINION

Tax Law § 1138(a)(1) provides that if "a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by (the

Division of Taxation) from such information as shall be available. If necessary, the tax may be estimated on the basis of external indices . . ." This language has been interpreted to provide that "[t]he honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate liability" (***Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 47 [1978]).

To determine the adequacy of a taxpayer's records, the Division must first request (***Matter of Christ Cella, Inc. v. State Tax Commn.,*** 102 AD2d 352 [1984]) and thoroughly examine (***Matter of King Crab Rest. v. Chu***, 134 AD2d 51 [1987]) the taxpayer's books and records for the entire period of the proposed assessment (***see***, ***Matter of Adamides v. Chu***, 134 AD2d 776 [1987], ***lv denied*** 71 NY2d 806 [1988]). The request for records must be explicit and not "weak and casual" (***Matter of Christ Cella, Inc. v. State Tax Commn., supra***, at 354).

The purpose of the examination is to determine, through verification drawn independently from within these records (***Matter of Giordano v. State Tax Commn.***, 145 AD2d 726 [1988]; ***Matter of Urban Liqs. v. State Tax Commn.***, 90 AD2d 576 [1982]; ***Matter of Meyer v. State Tax Commn.***, 61 AD2d 223 [1978], ***lv denied*** 44 NY2d 645 [1978]; ***Matter of Hennekens v. State Tax Commn.***, 114 AD2d 599 [1985]), that they are, in fact, so insufficient that it is "virtually impossible (for the Division of Taxation) to verify taxable sales receipts and conduct a complete audit" (***Matter of Chartair, Inc. v. State Tax Commn., supra***), "from which the exact amount of tax can be determined" (***see***, ***Matter of Mohawk Airlines v. Tully***, 75 AD2d 249 [1980]).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (***see***, ***Matter of Urban Liqs. v. State Tax Commn., supra***).

The Division asserts that it made an adequate request for petitioners' books and records, in that it requested "sales invoices" and made oral requests for cash register tapes. Petitioners dispute that oral requests were made for cash register tapes and that the first time such tapes were requested was in the undated memorandum accompanying the Statement of Proposed Audit Adjustment on or about January 21, 2004.

As noted above, the Division's request for petitioners' records must be explicit and not weak and casual. In ***Matter of Trusnovec*** (Tax Appeals Tribunal, April 10, 1997), considering this requirement, we stated:

> The threshold requirement, that the Division must first request and thereafter thoroughly examine a taxpayer's books and records before resorting to external indices as the basis for an audit, is not a statutory mandate. There is little guidance for determining what constitutes an adequate request for books and records by the Division other than that the request for records must be explicit and not weak and casual. There is no formal or informal requirement to send such a request by registered or certified mail.
>
> In the instant case, the auditor testified and the Administrative Law Judge found that the request for books and records was mailed to petitioner three times by ordinary mail and once by certified mail . . . .
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> * * * * *
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> Four detailed requests for records were mailed to petitioner, three by first class mail, which were not returned to the Division, and one by certified mail (return receipt requested), which was left unclaimed and returned, at an address he had provided to the Division . . . We conclude that an adequate request for records was made and that when petitioner did not respond, it was prudent and reasonable for the Division to proceed with their audit . . . .
>
> The silence of the Tax Law and regulations with regard to the form of requests for books and records accords the Division broad discretion in the mode it chooses to use in any particular circumstance. In this case, the use of first class and certified, return receipt requested mail was more than a weak and casual request for books and records (***Matter of Christ Cella, Inc. v. State Tax Commn., supra*** . . . .
>
> Although there have been cases where the Division has personally delivered requests for books and records to a taxpayer (***see, Matter of Burbacki***, Tax

> Appeals Tribunal, February 9, 1995 [where personal service of a request for books and records overcame assertion that the taxpayers did not receive a subsequent request sent by certified mail] and ***Matter of DeFilippis Crane Serv.***, Tax Appeals Tribunal, June 9, 1994 [where appointment letter with attached checklist mailed to taxpayer coupled with personally delivered supplemental list of records and oral request for records of subsequent tax period was found to be an adequate request]), it has never been required . . . .

It is clear to us that the Division's repeated written requests for sales invoices, while knowing that petitioners did not employ sales invoices in its business, did not constitute an adequate request to have petitioners produce its cash register tapes in this case. By the auditor's own admission, he knew that the business was a cash business, and he acknowledged that he should have used a different "Records Requested List" enclosure (which contained a detailed list of ***all*** records required to be available for audit on the appointment date) with his appointment letter. Had he done so, he would have had a record of having specifically requested that petitioners provide their cash register receipts for review.

When petitioners' cash register tapes were finally requested in writing (January 20, 2004), petitioners did not refuse to produce them. Instead, petitioners asked for sufficient time to organize them so that they could be reviewed by the auditor. The auditor agreed and an appointment date was set for delivery and review of the tapes. Despite this, the auditor issued an assessment prior to this appointment date and without having first determined if petitioners' records were sufficiently accurate to verify taxable receipts and to conduct a complete audit.

It is clear from the testimony of the auditor and the chronology of events that the Division rushed to issue an assessment in order to preserve the liability of the bulk sale purchaser. However, the Division also issued this assessment prior to actually determining whether or not petitioner had adequate books and records (i.e., cash register tapes) and that there was, in fact, a deficiency of sales tax reported by petitioners.

The auditor testified that he found that there was basic agreement between gross sales per petitioners' books and gross sales reported on petitioners' sales tax returns and federal income tax returns. At the time that the auditor issued an assessment, there was no indication in the auditor's Field Audit Report that he had yet discovered a deficiency in the amount of gross sales reported or sales tax collected and remitted. Instead, the auditor claimed that no detailed sales records had been provided, so he deemed petitioners' records to be inadequate. Further, the auditor claimed that "the prior audit at this location showed sales to be much higher than this vendor reported." Therefore, relying on the observation employed in an audit of petitioners' predecessor in business instead of conducting an examination of petitioners' detailed sales records (which petitioners' representative had agreed to provide), the auditor then presumed, rather than determined, that petitioners had grossly underreported their taxable sales in order to bind the bulk sale purchaser for this same liability.

As they did before the Administrative Law Judge, the parties have argued numerous issues before us. However, we need not decide them because we conclude, as did the Administrative Law Judge, that the assessments issued to petitioners are flawed because the Division did not first request, and when finally requested, did not examine, petitioners' records to determine their accuracy prior to issuing its assessment. As a result, we affirm the Administrative Law Judge's determination and cancel the Notices of Determination that were issued in this matter.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

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

3. The petitions of Raccagna Foods, Inc. and Grace Raccagna are granted; and

4. The Notices of Determination dated February 19, 2004 and March 12, 2004 are cancelled.

DATED:Troy, New York
March 16, 2010

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

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