

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petitions :  
of : DECISION  
**BOK HUI NAM** : DTA NOs. 821515 and 822016  
for Redetermination of Deficiencies or for Refund of :  
Personal Income Tax under Article 22 of the Tax :  
Law for the Years 2000 through 2003. :

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Petitioner, Bok Hui Nam, filed an exception to the determination of the Administrative Law Judge issued on October 2, 2008. Petitioner appeared by Pfeiffer & Pfeiffer, PC (Raymond M. Pfeiffer, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Michele Milavec, Esq., of counsel).

Petitioner filed a brief in support of her exception. The Division of Taxation filed a letter brief in lieu of a brief in opposition. Petitioner filed a letter brief in reply. Oral argument, at petitioner's request, was heard on March 25, 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 properly determined additional income tax due by using the results of a previous sales tax audit.

II. Whether petitioner demonstrated reasonable cause to justify abatement of penalties asserted with respect to the income tax deficiencies.

***FINDINGS OF FACT***

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

Petitioner, Bok Hui Nam, owned and operated the Korean Express Restaurant, which was located on the campus of the University of Buffalo, Amherst, New York. During the years at issue, petitioner filed New York State resident income tax returns, Form IT-201, reporting income from Korean Express on the included Schedule C of her federal income tax return for each of the years at issue.

Petitioner's business operation was the subject of a sales tax audit for the period September 1, 2000 through August 31, 2003 by the Division of Taxation (Division). Due to the failure of the business to maintain complete and accurate records of its sales, costs and expenses, the Division resorted to an observation audit, which was conducted on April 15, 2004. The auditor calculated an error rate based on the observation of the business operation, multiplied it by the total sales for that day and divided the result by the number of hours the business was open to determine an average amount of sales per hour. The auditor then multiplied the average sales per hour times the number of hours the restaurant was open for the quarter ended May 31, 2004 to compute the taxable sales for that quarter.

The taxable sales computed for the quarter ended May 31, 2004 were compared to the taxable sales as reported on that quarter's sales tax return to calculate an error rate of 2.397. This error rate was then applied to the taxable sales as reported for each quarter of the audit period at issue in order to calculate audited taxable sales. The taxable sales reported on the sales tax returns were subtracted from audited taxable sales to arrive at additional taxable sales for the tax period September 1, 2000 through August 31, 2003. On August 20, 2004, petitioner executed a Consent

to the Statement of Proposed Audit Change for Sales and Use Tax, dated August 12, 2004, for the period September 1, 2000 through August 31, 2003.

By letter dated September 15, 2004, the Division advised petitioner that her New York State personal income tax returns for the years 2000, 2001, 2002 and 2003 had been selected for audit based upon a referral from the Sales Tax Audit Bureau. The Division further advised that information received from the Sales Tax Audit Bureau indicated that gross receipts as reported on Schedule C of petitioner's New York State personal income tax return might be understated. The Division further advised that this information would be incorporated into the results of the income tax audit.

On October 20, 2004, the Division informed petitioner that the previous sales tax audit revealed that gross receipts as reported on Schedule C of the New York State income tax returns were understated and a personal income tax audit adjustment resulted in an increase in petitioner's tax liability for tax years 2000, 2001, 2002 and 2003. The statements of personal income audit changes accompanying the Division's letter of October 20, 2004 indicated additional personal income tax liability of \$8,207.00 for year 2000, \$8,058.00 for year 2001, \$10,433.00 for year 2002 and \$13,138.00 for year 2003.

The income tax deficiency was determined by applying the error rate of 2.397 to the taxable sales as reported by petitioner on her Schedule C for each year to arrive at audited taxable sales. For the January/February period and the December period, taxable sales were estimated by taking the total taxable sales reported for the year, as indicated on the Schedule C, less the taxable sales reported for the period March 1 through November 30, as indicated on the filed sales tax returns, and dividing the total by two. From audited taxable sales, the auditor subtracted taxable sales previously reported, resulting in additional taxable sales per audit for each of the tax years at

issue. In determining the additional tax due for the period January 1, 2000 through August 31, 2000, a period not covered by the sales tax audit, the Division applied the sales tax error rate to taxable sales as reported by petitioner for such period.

In a letter dated January 24, 2005, petitioner proposed that as the sales tax audit of the business was based upon estimated sales, it would be appropriate to allow additional estimated costs on the increased sales. The Division rejected petitioner's proposal, stating that an adjustment to costs would be made should documentation supporting such an increase be provided.

By facsimile dated July 19, 2005, petitioner forwarded to the Division copies of unsigned amended resident income tax returns, Form IT-201X, for the tax years 2000, 2001, 2002 and 2003. In response to the Division's inquiry of August 5, 2005 as to whether the amended returns had been filed and what specific adjustments were made for each year, petitioner stated in a letter dated August 8, 2005 that the amended returns had not been filed and that the returns reflected the cost of goods for each year in question being increased by 50% to conform to the increased estimate of sales determined in the sales tax audit.

On February 6, 2006, the Division issued to petitioner a Notice of Deficiency for the year 2000 asserting personal income tax due of \$8,207.00, plus penalty and interest. On the same date, the Division issued a second Notice of Deficiency for the years 2001, 2002 and 2003 asserting personal income tax due of \$31,629.00, plus penalty and interest. Penalties were assessed for each year pursuant to Tax Law § 685(b)(1) and (2) for negligence and Tax Law § 685(p) for the substantial understatement of income.

Petitioner immigrated to the United States from Korea in 1986. In 1999, she came to Buffalo from Las Vegas, Nevada, and opened the Korean Express Restaurant. Petitioner operated

the business from space she rented on the State University of New York at Buffalo campus from U.B. Commons, Inc. As most of the business's customers were University of Buffalo students, petitioner's business earnings were greater when the university was in session during the months of September, October, November, early December, February, March, April and early May.

Petitioner purchased a home in the Buffalo area on December 20, 2002, at a purchase price of \$235,000.00. Petitioner received a mortgage in the amount of \$211,500.00 and made a down payment of \$20,000.00, an amount she received from her father to purchase the house. During the period 2001 through 2003, petitioner deposited a total of \$103,497.00 into her personal checking account maintained at the M & T Bank.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

Petitioner's personal income tax liability is derived from a sales tax audit of the Korean Express Restaurant, of which Bok Hui Nam was the sole owner. The Administrative Law Judge noted that petitioner admitted that she failed to maintain a complete set of books and records of her sales, costs and expenses. Accordingly, the Administrative Law Judge found that without such records the Division properly performed an observation audit to determine petitioner's taxable sales for the subject period. The resulting error rate was then applied to the reported taxable sales, to arrive at additional audited taxable sales and additional sales tax due. The Administrative Law Judge observed that petitioner consented to the determination of the sales tax audit, and the audited additional gross receipts were added to petitioner's gross receipts as reported on her federal schedule C, increasing her personal income liability for the years 2000, 2001, 2002 and 2003. For the year 2000, the sales tax audit covered only the period September 1, 2000 through December 31, 2000. For that portion of the year 2000, prior to the sales tax audit

period, the Division determined additional income by applying the sales tax error rate to taxable sales reported by petitioner during this period.

The Administrative Law Judge rejected petitioner's argument that the Division erroneously computed her income. The Administrative Law Judge pointed out that petitioner admitted that she failed to keep accurate books and records of her sales, costs and expenses relating to the operation of her business. It was this lack of books and records, the Administrative Law Judge observed, that resulted in the Division conducting an observation audit, which resulted in a determination of additional sales tax due. Petitioner agreed to that audit result, and signed the consent to the Statement of Proposed Audit Adjustments for the sales tax assessment, reflecting her agreement with the figures contained therein. The Administrative Law Judge also found that the Division's use of these figures to determine the amount of additional unreported income for income tax purposes was proper. The Administrative Law Judge also determined that the method chosen and utilized by the Division to compute the additional personal income tax due was also proper. Since the Administrative Law Judge found that the income tax deficiency determined by the Division was proper, the Administrative Law Judge observed that it was the taxpayer's burden to prove by clear and convincing evidence that the deficiency and the method used to determine the additional amount of tax due were erroneous.

The Administrative Law Judge noted that indirect audit methods are proper in personal income tax audits of a taxpayer's income, where such income is not accurately reflected in his/her books and records.

The Administrative Law Judge pointed out that petitioner's argument, that the business's cost of goods sold should be increased by 50% was not supported by the evidence, as petitioner

failed to maintain any records of individual sales during the audit period, and the claimed costs associated with such sales.

In determining the additional tax due for the period January 1, 2000 through August 31, 2000, a period not covered by the sales tax audit, the Division applied the audited sales tax error rate to taxable sales as reported by petitioner for such period. The Administrative Law Judge found that this projection of the sales tax error rate to the period January 1, 2000 through August 31, 2000 was a proper method for calculating income earned and the applicable income tax by indirect audit method.

The Administrative Law Judge also rejected petitioner's claim that the Tax Appeals Tribunal's decision in *Matter of Rosemellia* (Tax Appeals Tribunal, March 12, 1992) supports her position that the Division erred in not computing a cost of goods sold for the additional business income determined by the sales tax audit, as not supported by the record of this matter. The Administrative Law Judge pointed out that in *Rosemellia*, the taxpayer maintained books and records. Unlike the *Rosemellia* case, petitioner had no books and records that could be used to compute a cost of goods sold or to determine additional operating expenses for the business.

The Administrative Law Judge found that with regard to penalties, petitioner's admitted failure to maintain records of the business's sales, costs and expenses and her admission that she had additional sales to that reported on her schedule C for each of the years at issue, supported the imposition of the negligence penalty. The Administrative Law Judge determined that petitioner failed to show reasonable cause for the failure to file and pay the taxes due and, thus, the imposition of penalties by the Division were sustained (Tax Law § 685[a][1];[b][1], [2]; Tax Law § 685[p]) and the petition was denied.

***ARGUMENTS ON EXCEPTION***

On exception, petitioner argues, as she did below, that it was unreasonable for the auditor to fail to include an estimate of 50% gross sales as the cost of goods sold and deduct it from the audited additional gross sales. Petitioner urges that the income tax assessment be reduced by an amount that takes into account her claimed costs. In addition, petitioner claims that the audit method employed to determine the income tax deficiency for the earlier portion of the tax year 2000 was unreasonable. Petitioner states that since she did not maintain books and records for her business, the auditor must use a reconstruction of income method to determine petitioner's personal income tax liability. Petitioner argues that the audit method used in the sales tax audit was arbitrary and unreasonable. Petitioner also maintains that she did not agree to have the sales tax audit results be used to determine her personal income tax liability.

Finally, petitioner continues to argue that our decision in *Matter of Rosemellia, supra*, supports her claim that the Division was required to establish an estimate of her cost of goods sold. Petitioner has not raised the issue of penalties on exception.

The Division urges that we affirm the determination of the Administrative Law Judge.

***OPINION***

The issues raised here are not a matter of first impression with us. In *Matter of R & J Automotive Inc.* (Tax Appeals Tribunal, June 15, 1989), we stated that:

In a sales and use tax audit, resort to external indices as a method of computing sales tax liability must be founded upon a determination of the insufficiency of the taxpayer's record keeping which makes it virtually impossible to verify sales receipts and conduct a complete audit (*Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41). This standard, requiring demonstrably inadequate records before an indirect auditing technique may be used, has been explicitly rejected in audits of income for personal income, non-resident earnings and unincorporated business taxes (*Matter of Giuliano v. Chu*, 135 AD2d 893, 521 NYS2d 883; *Matter of Hennekens v. State Tax*



*Commn.*, 114 AD2d 599, 494 NYS2d 208). The distinction between an income tax audit and a sales tax audit centers on the type of tax being imposed (*Hennekens v. State Tax Commn., supra*). While sales tax audits seek recovery of taxes imposed directly upon verifiable receipts as evidenced by books and records which are required to be maintained (*Matter of Licata v. Chu*, 64 NY2d 873, 874, 487 NYS2d 552) audits involving the imposition of tax on income concern the receipt of income which cannot easily be verified by reference to books and records (*Matter of Hennekens v. State Tax Commn., supra*). The standard articulated by the courts of New York concerning audits of income is that indirect auditing methods are proper where the taxpayer's income is not accurately reflected in his books and records (*see, Matter of Giuliano v. Chu, supra; Matter of Hennekens v. State Tax Commn., supra; Matter of Checho v. State Tax Commn.*, 111 AD2d 470, 488 NYS2d 859).

Petitioner argues that the Division should have conducted an income reconstruction audit rather than an observation test, and that any such audit should give her credit for the cost of goods sold. Where, as here, the taxpayer has failed to maintain a verifiable set of books and records, the Division may proceed with an estimated audit; and we do not require any particular type of audit, so long as the audit method is reasonable and the amount asserted as due is not erroneous. It is petitioner's burden to prove by clear and convincing evidence that the audit method was unreasonable or that the amount asserted was erroneous (*see, Scarpulla v. State Tax Commn.*, 120 AD2d 842 [3<sup>rd</sup> Dept 1986]). If there are any facts or reasonable inferences from the facts to support the Division's determination, the assessment should be confirmed (*see, Levin v. Gallman*, 42 NY2d 32 [1977]). Petitioner has not offered such evidence.

Petitioner's argument that the Division erroneously computed her income does not take into account the Division's right to utilize an indirect audit method in the case of personal income tax, where receipt of the income cannot easily be verified by reference to books and records (*see, Hennekens v. State Tax Commn., supra*). Petitioner's argument is also unsupported by evidence. The affidavits of petitioner and her accountant were, as the Administrative Law Judge pointed out, not contemporaneous business records of petitioner's sales and purchases and are

unverifiable. The affidavits were merely petitioner's estimate of her liability. Petitioner admitted that she failed to keep accurate books and records of her sales, costs and expenses relating to the operation of her business. Due to the lack of books and records, the Division conducted an observation audit that resulted in a determination of additional sales tax due, to which petitioner consented. Since the audit showed that petitioner had additional unreported sales, ultimately this resulted in an audited increase in petitioner's income and the issuance of a Notice of Deficiency. Once a Notice of Deficiency is properly issued by the Division, a presumption of correctness attaches to such notice, and as we stated earlier, the burden is on petitioner to overcome that presumption by clear and convincing evidence (*see*, Tax Law § 689[e]).

Given that petitioner signed the consent to the Statement of Proposed Audit Adjustments for the sales tax assessment, indicating agreement with the figures contained therein, we find that the Division's use of these figures to determine the amount of petitioner's additional unreported income as income was proper (*see, Matter of Rosemellia, supra*). The determination of additional sales provided a factual basis for the Division to decide that the income reported by petitioner on her personal income tax returns was not accurate, and it was appropriate for the Division to use the audited additional sales to determine petitioner's unreported income for the years at issue (*see, Matter of Bruno*, Tax Appeals Tribunal, May 13, 1993; *see also, Matter of Bonanno*, Tax Appeals Tribunal, December 13, 1990).

As we noted earlier, the taxpayer bears the burden of proving by clear and convincing evidence that the deficiency and the method used to determine the additional amount of tax due were erroneous (*see, Matter of Leogrande v. Tax Appeals Tribunal*, 187 AD2d 768 [1992], *lv denied*, 81 NY2d 704 [1993]). Petitioner's evidence fails in this regard. We also reject

petitioner's argument that she should be given credit for her business's cost of goods sold. This record is devoid of any contemporaneous, verifiable documentary evidence to support this argument, as petitioner failed to maintain any records of individual sales during the audit period, and the claimed costs associated with such sales. All we have is petitioner's own estimate of her costs at 40 to 50 percent of her gross profit (Petitioner's Ex. 1, paragraph 20). Accordingly, we reject this argument as not supported by the record. While by law, the Division is entitled to estimate sales and sales tax due, the law does not extend the same privilege to taxpayers. In any event, petitioner's alternative estimate does not prove that the Division's audit methodology was erroneous (*see, Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858 [1981]). We find that given petitioner's agreement with the audit results, the sales tax audit methodology was not unreasonable and the sales tax figures provided a proper basis for the income tax assessment. As petitioner failed to introduce any source documentation showing her additional operating expenses or other increased costs, she must yield to the presumption of correctness (*see, Matter of Tavolacci v. State Tax Commn.*, 77 AD2d 759 [1980]), and no adjustment to the audit findings is warranted.

We also reject, for the same reasons, petitioner's argument that the Division's use of the audit method employed to determine the income tax deficiency for the portion of the year 2000 that was not covered by the sales tax audit was improper. In determining the additional tax due for the period January 1, 2000 through August 31, 2000, a period not covered by the sales tax audit, the Division applied the sales tax error rate to taxable sales as reported by petitioner for such period. In the absence of clear and convincing proof to the contrary, the projection of the sales tax error rate to that period is a proper method for calculating income earned and the

applicable income tax by indirect audit method (*see, Matter of Bruno, supra; Matter of Tivolacci v. State Tax Commn., supra*).

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Bok Hui Nam is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Bok Hui Nam are denied; and
4. The notices of deficiency dated February 6, 2006 are sustained, together with penalty

and interest.

DATED: Troy, New York  
September 24, 2009

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

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