

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petitions	:	
of	:	
<b>SHREE PURSHOTTAM CORPORATION</b>	:	DECISION
<b>AND PIYUSH PATEL, AS OFFICER</b>	:	DTA NOS. 821913
	:	AND 821867
for Revision of Determinations or for Refund of	:	
Sales and Use Taxes under Articles 28 and 29 of the	:	
Tax Law for the Period June 1, 2003 through	:	
May 31, 2006.	:	

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Petitioners, Shree Purshottam Corporation and Piyush Patel, as officer, filed an exception to the determination of the Administrative Law Judge issued on July 9, 2009. Petitioners appeared by Bailey & Sherman, P.C. (Edward G. Bailey, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioners did not file a brief in support of their exception. The Division of Taxation filed a letter brief in opposition. Petitioners did not file a reply brief. Petitioners' request for oral argument was denied.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision. Commissioner Tully took no part in the consideration of this matter.

***ISSUES***

I. Whether the Administrative Law Judge correctly determined that the Division of Taxation's method of estimating taxable sales was reasonably calculated to reflect the taxes due.

II. Whether the Administrative Law Judge correctly determined that petitioners failed to establish any facts or circumstances warranting the reduction or abatement of penalties imposed.

***FINDINGS OF FACT***

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

Petitioner Shree Purshottam Corporation (the store) operated a convenience store in Rochester, New York. The store sold a variety of items such as dairy products, baked goods, cigarettes, lottery tickets, hot coffee, phone cards, beer and nonalcoholic drinks. Piyush Patel was the only individual with an ownership interest in the corporation. At the time of the hearing, the corporation was no longer in business. However, when it was operating, three individuals, including Mr. Patel, worked at the store.

In April 2006, the Division of Taxation (Division) commenced a field audit of the store. The Division reviewed the store's tax returns and contacted Mr. Patel in order to schedule an audit appointment. Mr. Patel replied that he wished to have the assistance of his accountant, Bharat Magdalia, CPA, during the conduct of the audit.

On May 22, 2006, the Division sent an appointment letter to Mr. Magdalia advising him that the store's sales and use tax records had been scheduled for a field audit for the period June 1, 2003 through May 31, 2006. The letter stated that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." A schedule of books and records to be produced was attached to the letter.

Initially, the auditor did not receive any records in response to the letter. Subsequently, the Division was provided with purchase invoices from suppliers, daily z-tapes,<sup>1</sup> federal and state

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<sup>1</sup> A z-tape is a departmentalized daily summary of the sales recorded on a cash register. A z-tape does not show the details of each transaction.

corporate returns, bank statements and the worksheets that the accountant used to prepare the sales tax returns for the audit period.

The Division reviewed the cigarette purchase invoices for the period March 2004 through August 2005 and compared the cigarette tax credits listed on the purchase invoices to the credits claimed on the store's sales tax returns in order to determine if the credits claimed on the sales tax returns were accurate. The Division concluded that petitioners accurately reported the amount of the prepaid cigarette tax credit.

The Division found that the petitioners' books and records were inadequate because the Division could not trace the sales tax collected to a sales tax return. In this regard, the Division noted that the sales tax recorded on the z-tapes did not match the sales tax recorded on the returns. The Division was informed that cigarettes were sold with the taxes included in the sales price. As a result, store employees entered the cigarette sales on the cash register as "grocery non-taxable" so that the cash register would not add sales tax to the price.

The Division ascertained that the sales tax returns were not prepared from sales documents. Rather, petitioners' accountant calculated sales by multiplying purchases by an estimated markup.<sup>2</sup>

Since the sales records were unreliable, the Division decided to utilize the reported sales tax credits in conjunction with an observation test to determine the sales and use taxes due. The amount of the prepaid cigarette tax credit was utilized because it was the only number on the sales tax return that the Division could substantiate. Further, the Division could then use the

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<sup>2</sup> At the hearing, Mr. Patel testified that the amount of gross sales was obtained from the z-tapes and that petitioners' accountant estimated taxable sales on the basis of purchase invoices and a markup. This testimony is rejected because the record shows that the reported gross sales did not correspond with the z-tapes.

amount of the prepaid credit to calculate the number of packs of cigarettes that the corporation sold during the audit period.

The Division also considered the number of packs of cigarettes sold per day as a reasonable basis for estimating sales because it observed a correlation between the number of packs of cigarettes sold and the actual sales. According to the corporation's sales tax returns, the average taxable sale per pack was \$7.91. The highest taxable sale per pack was \$8.73 and the lowest was \$7.07. If there had not been a relationship between the number of packs of cigarettes sold and taxable sales, the Division would have expected a greater fluctuation. In the summer months, the corporation's sales were higher than in the winter months, and the corporation's prepaid cigarette credit was also higher. This indicated to the Division that the corporation was selling more cigarettes in the summer than in the winter. The Division also considered its sampling method to be accurate because its methodology did not show substantial variation in the number of packs of cigarettes sold. An examination of the period that included August 2005 showed sales of 147 packs per day, and sales during the period that included August 2004 showed sales of 153 packs per day.

On August 4, 2006, the two auditors observed the store's sales from opening to closing and recorded every transaction, placing them into taxable and nontaxable categories. The Division also recorded the number of packs of cigarettes sold during the day. The auditors observed total taxable sales of \$1,791.28 and 155 packs of cigarettes sold. The Division divided the observed taxable sales of \$1,791.28 by the 155 packs of cigarettes sold to determine that the corporation had taxable sales of \$11.56 for each pack of cigarettes sold. It then determined the number of packs of cigarettes sold during each quarter of the audit period by dividing the reported prepaid credits by the prepaid tax rate. The number of packs of cigarettes sold was then multiplied by the

taxable sales for each pack of cigarettes sold to determine the audited taxable sales. The reported taxable sales were subtracted from the audited taxable sales to calculate additional taxable sales of \$507,403.08 and additional tax due of \$41,405.18.

On the basis of its audit, the Division issued to the store a Notice of Determination, dated September 18, 2006, which assessed a deficiency of sales and use tax in the amount of \$41,405.18 plus penalty and interest for a balance due of \$63,102.87. It also issued a Notice of Determination to Piyush Patel, dated September 22, 2006, which assessed the same amount of sales and use tax plus penalty and interest for a balance due of \$63,386.30.<sup>3</sup> The Division assessed the statutory penalty because petitioners failed to produce actual sales records and because the underpayment of tax was substantial.

The corporation had one cash register. Mr. Patel usually printed the z-tapes at the end of the day. If a customer asked for a receipt, Mr. Patel would print it and hand it to the customer. Mr. Patel explained that he found it difficult to keep track of each receipt.

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

In his determination, the Administrative Law Judge noted that as vendors, petitioners were required to maintain complete, adequate and accurate books and records of their sales tax liability and make such records available for audit by the Division. The Administrative Law Judge concluded that petitioners failed to maintain detailed cash register tapes during the audit period and that the records that were maintained were not suitable to allow the Division to accurately determine taxable sales.

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<sup>3</sup> The difference in the total amounts assessed is attributable to additional penalty and interest accruing during the time between the issuance of the first and second assessments.

As a result, the Administrative Law Judge held that the Division was authorized to use an estimated audit method, so long as such method was reasonably calculated to reflect the taxes due. The Administrative Law Judge noted that the use of an observation test to determine sales is a well established and acceptable audit methodology. The Administrative Law Judge found that using sales of packs of cigarettes as a methodology to determine the corporation's taxable sales was supported by the consistent relationship between sales of packs of cigarettes and taxable sales, and that the day chosen for the observation test was representative of the corporation's business activity.

The Administrative Law Judge observed that the taxpayer has the burden to prove by clear and convincing evidence that the audit method chosen by the Division led to unreasonably inaccurate results or that the amount of tax assessed was inaccurate. The Administrative Law Judge considered petitioners' arguments and concluded that no adjustment to the assessed tax was warranted.

The Administrative Law Judge held that petitioners did not demonstrate that their failure to pay over the appropriate amount of sales tax was due to reasonable cause and not willful neglect. The Administrative Law Judge found that petitioners did not maintain records from which taxable sales could be accurately determined. He further found that petitioners were aware that certain taxable transactions were entered in a nontaxable category and they did not take steps to correct the problem. As a result, the Administrative Law Judge upheld the imposition of penalties.

#### ***ARGUMENTS ON EXCEPTION***

On exception, petitioners argue that when the Division estimates sales tax, it is the responsibility of the court to inquire as to the reasonableness of the audit performed. Despite the

fact that petitioners initially did not provide records to the Division, petitioners assert that the Division's audit method was totally unreasonable and should not be given consideration.

Petitioners claim that the Division failed to recognize that on the day it conducted its observation test, the business did not resemble the business that existed during the audit period. Petitioners maintain that the observation day preceded a festival weekend, which significantly inflated sales. Further, petitioners point out that the observation was conducted on a Friday, which is petitioners' busiest day and not representative. Finally, petitioners maintain that the use of cigarette sales to determine the sales of other products was not an accurate measure. Instead, petitioners argue that the Division should have conducted a mark-up test to determine petitioners' sales.

Petitioners assert that their failure to comply with the Tax Law was due to reasonable cause and not willful neglect because they relied on their accountant, who determined sales based on properly maintained books and records.

In opposition, the Division argues that the Administrative Law Judge was correct in his determination regarding the conduct of the audit, the Division's assessment of tax due and the imposition of penalties. The Division maintains that petitioners provided no credible testimony or other evidence at the hearing to warrant any adjustments in the assessment.

### ***OPINION***

Every person required to collect tax must maintain and make available for audit upon request records sufficient to verify all transactions in a manner suitable to determine the correct amount of tax due (*see*, Tax Law § 1135[a]; 20 NYCRR 533.2[a]). Failure to maintain and make available such records, or the maintenance of inadequate records, will result in the Division's estimating tax due.

To determine the adequacy of a taxpayer's books and records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776 [1987], *lv denied* 71 NY2d 806 [1988]; *Matter of King Crab Rest. v. Chu* 134 AD2d 51 [1987]). The purpose of such an examination is to determine whether the records are so insufficient as to make it virtually impossible to verify taxable sales receipts and conduct a complete audit. Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, it may resort to external indices to estimate tax (*Matter of Urban Ligs. v. State Tax Commn.*, 90 AD2d 576 [1982]). When estimating sales tax due, the Division must adopt an audit method that will reasonably calculate the amount of taxes due (*see, Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196 [1957], *cert denied* 355 US 869 [1957]), but exactness in the audit results is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023 [1976], *affd* 44 NY2d 684 [1978]).

The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842 [1986]) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858 [1981]). In addition, “[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, 950 [1986]). Whether the audit method used was “reasonably calculated to reflect the taxes due” (*Matter of W.T. Grant Co. v. Joseph, supra*, at 206) can only be determined based on information made available to the auditor before the assessment is issued (*see, Matter of Queens Discount Appliances*, Tax Appeals Tribunal,



December 30, 1993; *see also, Matter of House of Audio of Lynbrook*, Tax Appeals Tribunal, January 2, 1992).

In this case, the record establishes that petitioners did not maintain verifiable books and records for audit. Therefore, it was not possible for the Division to verify taxable sales and conduct a detailed audit. Where, as here, the Division properly requests and examines a taxpayer's books and records, thereby demonstrating that the records are incomplete or inaccurate, the Division may properly estimate the additional tax due, if any (*see, Matter of Urban Liqs. v. State Tax Commn., supra*).

We find that the Division's use of sales of packs of cigarettes in conjunction with an observation test as a methodology to estimate petitioners' taxable sales was reasonable. Further, we find that the evidence presented by petitioners fails to show by clear and convincing evidence that the audit results are inaccurate. Petitioner's testimony is not a substitute for verifiable books and records as required by the statute. Any imprecision in the audit results arises by reason of petitioners' failure to maintain adequate books and records as required by Tax Law § 1135(a)(1) and must be borne by the taxpayers (*see, Matter of Markowitz v. State Tax Commn., supra*).

Tax Law § 1145(a)(1)(i) authorizes the imposition of penalty for failure to pay any tax imposed under Articles 28 and 29 of the Tax Law. However, penalty may be abated if the failure to pay tax was due to reasonable cause and not due to willful neglect (*see, Tax Law § 1145[a][1][iii]*). Petitioner bears the burden of demonstrating the basis for an abatement of penalty. We agree with the Administrative Law Judge that petitioners did not meet their burden to show that their failure to pay tax was due to reasonable cause and not due to willful neglect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Shree Purshottam Corporation and Piyush Patel, as officer, is denied;

2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Shree Purshottam Corporation and Piyush Patel, as officer, are denied; and
4. The Notices of Determination dated September 18, 2006 and September 22, 2006, respectively, are sustained together with such penalty and interest due thereon.

DATED: Troy, New York  
May 27, 2010

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

/s/ Charles H. Nesbitt  
Charles H. Nesbitt  
Commissioner