

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

**HUAQUECHULA RESTAURANT
CORPORATION** :

for Revision of a Determination or for Refund of
Sales and Use Taxes under Articles 28 and 29 of the
Tax Law for the Period September 1, 2003 through
August 31, 2006. :

DECISION
DTA Nos. 822285 and
822298

In the Matter of the Petition :

of :

FIDEL J. LIRA :

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, 2004 through
August 31, 2006. :

Petitioners, Huaquechula Restaurant Corporation and Fidel J. Lira, filed an exception to the determination of the Administrative Law Judge issued on March 25, 2010. Petitioners appeared by Ballon Stoll Bader & Nadler, P.C. (Norman R. Berkowitz, Esq., of counsel). The Division of Taxation appeared by Mark Volk, Esq. (Robert Tompkins, Esq., of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a letter brief in lieu of a formal brief in opposition. Petitioners filed a reply brief. Oral argument, at petitioners' request, was heard on November 17, 2010 in New York, New York.

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

ISSUES

I. Whether the Division of Taxation's determination upon audit that petitioner Huaquechula Restaurant Corporation owed additional sales tax, plus interest and penalties, was proper and should be sustained.

II. Whether petitioner Fidel J. Lira was personally liable for sales tax due on behalf of Huaquechula Restaurant Corporation as a person required to collect and pay tax under Tax Law §§ 1131 and 1133.

FINDINGS OF FACT

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

Petitioner Huaquechula Restaurant Corporation owned and operated the Guadalajara Mexican Restaurant located in Briarcliff Manor, New York. Fidel J. Lira was the corporation's president, sole officer and 100% shareholder. The restaurant hours were 11:00 A.M. to 10:00 P.M., Sunday through Thursday, and 11:00 A.M. to 11:00 P.M., Friday and Saturday.

On August 25, 2006, the Division of Taxation (Division) sent a letter to Huaquechula Restaurant Corporation stating that a sales and use tax field audit of the business operation was to be conducted for the period September 1, 2003 through August 31, 2006. The Division's letter requested that all of the business's books and records for the audit period be available for review. Among the records specifically requested were the sales tax records, New York State corporation tax returns, sales invoices, exemption documents, fixed asset purchase and sales invoices, expense purchase invoices, bank statements, cash receipts journal, cash disbursements

journal, federal income tax returns, cash register tapes, depreciation schedules and canceled checks.

On November 17, 2006, the corporation, by its accountant, executed a Consent Extending Period of Limitations for Assessment of Sales and Use Taxes under Articles 28 and 29 of the Tax Law extending the period in which to assess sales and use taxes due for the period September 1, 2003 through May 31, 2004 to June 20, 2007.

The corporation did not provide the auditor with sales invoices, sales journals, cash sales receipts, credit card sales receipts, cash register tapes, guest checks or other source documentation detailing the amount of retail sales of the business operation. In addition, the corporation did not provide the auditor with fixed asset purchase and sales invoices, expense purchase invoices or exemption documents. The only documents made available to the auditor were the corporation's U.S. corporation income tax returns, form 1120.

As a result of the inadequacy of the books and records relating to the amount of the business's sales, and the inability to trace any transaction back to the original source or forward to a final total, the auditor determined that a detailed audit would not be possible and decided to perform an observation test.

On January 29, 2007, the Division mailed a letter to the corporation's accountant stating that the books and records of the business operation were insufficient to determine if the proper amount of sales tax had been reported for the audit period. As a result, the Division indicated that it would be conducting an observation of the business to record sales activity for an entire day.

On February 16, 2007, a Friday, the auditor went to the business unannounced to conduct an observation test. Petitioner's representative refused to allow the auditor to conduct the

observation and told him to leave the premises. In a subsequent telephone conversation, the representative stated that he would allow an observation on a Monday, Tuesday or Wednesday only, and with a specific day scheduled. The auditor explained that only an unannounced observation could be performed to prevent any manipulation that could distort the test.

Having been provided with no source documentation that established the amount of the business's sales and denied the opportunity to perform an observation test, the auditor decided to use a previously performed unannounced head count to estimate the amount of the corporation's sales. On January 19, 2007, an investigator of the Division had observed and counted the number of people entering the restaurant between the hours of 5:30 P.M. and 10:30 P.M. The investigator counted 239 people during that time frame.

The auditor determined an hourly average of customers of 47.8 ($239/5$), which was applied to daily business hours of 7 per day (5 hours for dinner and 2 hours for lunch) to arrive at a total number of customers per day of 335. An average check price per customer was determined by averaging the price of meals from the menu. In determining the average, the auditor used the cost of meals, salads and children's meals and did not use the cost of any appetizers, soups or desserts, although they were indicated on the menu. An average beverage price of \$3.00 was added to determine the average check price per person. Alcoholic beverages were listed on the menu, but were not considered in calculating the average beverage price.

The auditor computed daily sales of \$6,646.40 by multiplying the daily head count of 335 by the average check price of \$19.84. The daily sales figure of \$6,646.40 was multiplied by the total number of days of the audit period of 1,096 to determine audited taxable sales of \$7,284,454.40 for the period at issue. Reported taxable sales of \$1,715,421.00 were subtracted from audited taxable sales to arrive at additional taxable sales per audit of \$5,569,033.40. An

error rate calculation was used by the auditor to determine the additional sales per quarter and the applicable sales tax rate was applied to arrive at additional sales tax due per quarter. Total additional sales tax due for the audit period was \$410,273.00.

Bank statements were obtained by the auditor through the issuance of subpoenas to the corporation's banks. The auditor determined that bank deposits for the period at issue exceeded reported sales by \$2,242,920.48.

The auditor used the corporation's U.S. corporation income tax returns to determine the amount of expense and asset purchases for the period at issue. As no records were provided by petitioners to establish that sales tax had been paid on these purchases, the auditor assessed sales tax on recurring expense purchases of \$106,714.67 and asset purchases of \$141,122.96, resulting in additional sales tax due of \$7,861.71 and \$10,396.58, respectively.

On April 30, 2007, the Division of Taxation issued to petitioner Huaquechula Restaurant Corporation a Notice of Determination asserting additional sales tax due for the period September 1, 2003 through August 31, 2006 in the amount of \$428,531.18, plus penalty and interest.

On the same date, the Division of Taxation issued to petitioner Fidel J. Lira, as an officer or responsible person of Huaquechula Restaurant Corporation, a Notice of Determination asserting additional sales tax due for the period March 1, 2004 through August 31, 2006 in the amount of \$364,350.05, plus penalty and interest.

As previously noted, Fidel J. Lira was the corporation's president, sole officer and 100% shareholder. He signed, as president, the sales and use tax returns for the quarters ended May 31, 2004 through August 31, 2006, as well as the checks that accompanied the returns in payment of the sales tax due. Mr. Lira also signed, as president, the corporation's general business

corporation tax returns, form CT-3, for the years 2003, 2004, 2005 and 2006, as well as the attached checks. Mr. Lira was present at the hearing but did not testify.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

At the outset, the Administrative Law Judge discussed the relevant law, which imposes a sales tax on receipts from every retail sale of tangible personal property (Tax Law § 1105[a]). Under the statute, a “retail sale” is “a sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . .” (Tax Law § 1101[b][4][i]). The Tax Law requires those engaged in making such sales to file sales tax returns, and if a sales tax return 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 may be available. If necessary, the tax may be estimated on the basis of external indices . . .” (Tax Law § 1138[a][1]).

When acting pursuant to section 1138(a)(1), the Administrative Law Judge observed that the Division is only required to select a method reasonably calculated to reflect the tax due.

The Administrative Law Judge followed the standard for reviewing a sales tax audit where external indices were employed, which we enunciated in *Matter of Your Own Choice* (Tax Appeals Tribunal, February 20, 2003) as follows:

To determine the adequacy of a taxpayer’s records, the Division must first request [citations omitted] and thoroughly examine [citations omitted] the taxpayer’s books and records for the entire period of the proposed assessment [citations omitted]. The purpose of the examination is to determine, through verification drawn independently from within these records [citations omitted] 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” [citations omitted] “from which the exact amount of tax due can be determined” [citations omitted].

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 [citations omitted]. The estimate methodology utilized must be

reasonably calculated to reflect taxes due, [citations omitted] but exactness in the outcome of the audit method is not required [citations omitted]. The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous [citations omitted] or that the audit methodology is unreasonable [citations omitted]. In addition, “[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case” [citations omitted].

In this matter, the Administrative Law Judge found that the Division made a proper request for the restaurant’s books and records. In response, petitioners presented only the corporation’s U.S. corporation income tax returns. The Administrative Law Judge found that these records were insufficient to verify taxable sales, as there were no sales records included that would allow the auditor to trace any transaction back to the original source or to independently verify the amount of taxable sales. The Administrative Law Judge found that the poor state of the records presented made it impossible to verify taxable sales through a complete audit from which the exact amount of tax due could have been determined. Accordingly, the Administrative Law Judge determined that it was proper for the Division to resort to the use of external indices. The Administrative Law Judge went on to note that the courts have upheld the use of observation tests as an external index and have found it reasonable to extrapolate the results of a one-day observation or multiple-day test over a multi-year audit period (*see Matter of Sarantopoulos v. Tax Appeals Trib.* 186 AD2d 878 [1992]; *Matter of Vebol Edibles v. Tax Appeals Trib.*, 162 AD2d 765 [1990], *lv denied* 77 NY2d 803 [1991]). Accordingly, the Administrative Law Judge found it reasonable for the Division to utilize an observation test to estimate the restaurant’s sales and its resulting sales tax liability.

The Administrative Law Judge rejected petitioners’ argument that the Division did not follow established procedure to determine the accuracy of the corporation’s books and records, because by requesting information from third-party suppliers prior to examining the

corporation's books and records, the Division had predetermined that the corporation's books and records were inadequate. The Administrative Law Judge noted that the purpose of the request and examination of a taxpayer's books and records is to insure that a taxpayer who maintains records as required will have those records examined by the Division on audit. As the court in *Matter of Chartair v. State Tax Commn.* stated, "the 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 tax liability" (65 AD2d 44, 47 [1978]). Consequently, an indirect audit methodology cannot be used unless a taxpayer's records are so insufficient that its sales cannot be verified or such records are unavailable. The Administrative Law Judge noted that the corporation did not produce any records pertaining to its business operation in response to the Division's request, and found that the Division was justified in employing an indirect audit methodology.

Petitioners next argued that the Division's estimate methodology was not reasonably calculated to reflect the proper tax due but was used to achieve the highest possible amount of tax due. Petitioners also claimed that the head count did not properly account for employees, children and two large parties occurring at the time of the head count. Finally, petitioners argued that it was unreasonable to assume that no sales tax had been paid on any of the capital or expense purchases.

The Administrative Law Judge found that these arguments did not satisfy the taxpayers' burden of proving by clear and convincing evidence that the audit methodology was erroneous or that the assessment was incorrect (*see Matter of Sarantopoulos v. Tax Appeals Trib., supra*). The Administrative Law Judge pointed out that the Division computed the average cost of a customer's meal by including in its cost computation the price of meals, salads and children's

meals, and excluded the cost of any appetizers, soups or desserts, although they appeared on the menu. In addition, the average beverage price was computed without the cost of alcoholic beverages, although they were also listed on the menu. Further, the Administrative Law Judge found that petitioners cannot claim that the observation was flawed when it was they who refused the auditor an opportunity to conduct an observation test inside the restaurant, where more accurate customer numbers, costs of meals and beverages ordered could have been obtained and used in the audit calculation. The Administrative Law Judge found no evidence in the record to show that the Division's adjustments to sales were unwarranted.

The Administrative Law Judge also rejected petitioners' claim that it was unreasonable for the auditor to assume that no sales tax had been paid on any of its capital or expense purchases, noting that petitioners presented no documentation that such sales tax had been paid on such purchases.

Petitioners, in essence, appeared to take issue with the Division's audit result because it is imprecise. The Administrative Law Judge observed that any imprecision in the results of an audit arising by reason of a taxpayer's own failure to keep and maintain records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (*see Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023 [1976], *aff'd* 44 NY2d 684 [1978]; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223 [1978], *lv denied* 44 NY2d 645 [1978]), and the Administrative Law Judge noted that petitioners presented no evidence to satisfy this burden. The Administrative Law Judge found that petitioners' failure to maintain or provide records of its purchases and sales did not provide a basis for changing the Division's audit results.

The Administrative Law Judge further noted that where a taxpayer raises a statute of limitations defense to an assessment, the taxpayer has the burden of making a prima facie

showing of when the limitations period commenced, when it expired and the mailing or receipt of a statutory notice after the running of the period. Where the taxpayer meets this burden, the Division then has the burden of going forward to show that the statutory bar does not apply (*see Matter of Pittman*, Tax Appeals Tribunal, February 20, 1992; *Matter of Jencon*, Tax Appeals Tribunal, December 20, 1990). Here, petitioners did not introduce any evidence to establish when the statute of limitations period commenced. Therefore, the Administrative Law Judge found that the Division was not required to provide proof that it properly mailed the Notices of Determination to petitioners.

Next, the Administrative Law Judge addressed whether Fidel J. Lira was liable as a responsible officer of the corporation. Tax Law § 1133(a) imposes upon any person required to collect the tax imposed by Article 28 of the Tax Law personal liability for the tax imposed, collected or required to be collected. A person required to collect tax is defined to include, among others, corporate officers and employees who are under a duty to act for such corporation in complying with the requirements of Article 28 (Tax Law § 1131[1]).

The Administrative Law Judge observed that the mere holding of a corporate office does not, per se, impose tax liability upon an office holder (*Matter of Unger*, Tax Appeals Tribunal, March 24, 1994, *confirmed* 214 AD2d 857 [1995], *lv denied* 86 NY2d 705 [1995]) and discussed the factors to be considered, as set forth in the Commissioner's regulations. These factors include whether a person is authorized to sign the corporation's tax returns, was responsible for managing or maintaining the corporate books or was permitted to generally manage the corporation (20 NYCRR 526.11[b][2]). The Administrative Law Judge cited our decision in *Matter of Constantino* (Tax Appeals Tribunal, September 27, 1990) wherein we stated:

[t]he question to be resolved in any particular case is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. The case law and the decisions of this Tribunal have identified a variety of factors as indicia of responsibility: the individual's status as an officer, director, or shareholder; authorization to write checks on behalf of the corporation; the individual's knowledge of and control over the financial affairs of the corporation; authorization to hire and fire employees; whether the individual signed tax returns for the corporation; the individual's economic interest in the corporation (*Cohen v. State Tax Commn.*, *supra*, 513 NYS2d 564, 565; *Blodnick v. State Tax Commn.*, 124 AD2d 437, 507 NYS2d 536, 538, *appeal dismissed* 69 NY2d 822, 513 NYS2d 1027; *Vogel v. New York State Dept. of Taxation & Fin.*, *supra*, 413 NYS2d 862, 865; *Chevlowe v. Koerner*, 95 Misc 2d 388, 407 NYS2d 427, 429; *Matter of William D. Barton*, [Tax Appeals Tribunal, July 20, 1989]; *Matter of William F. Martin*, *supra*; *Matter of Autex*, *supra*).

Citing our decision in *Matter of Goodfriend* (Tax Appeals Tribunal, January 15, 1998), the Administrative Law Judge noted that in order to prevail, petitioner Fidel J. Lira "was required to establish by clear and convincing evidence that he was not an officer having a duty to act on behalf of the corporation, i.e., that he lacked the necessary authority or he had the necessary authority, but was thwarted by others in carrying out his corporate duties through no fault of his own (citations omitted)."

The Administrative Law Judge noted that Fidel J. Lira was the corporation's president, sole officer and 100% shareholder. He signed, as president, the New York State and local sales and use tax returns for the quarters ended May 31, 2004 through August 31, 2006, as well as the checks that accompanied the returns in payment of the sales tax due. Mr. Lira also signed, as president, the corporation's general business corporation tax returns, for the years 2003, 2004, 2005 and 2006, as well as the attached checks. The Administrative Law Judge pointed out that petitioners were free to call witnesses at the hearing in this matter and to present evidence to refute any of the evidence offered by the Division. Petitioners chose not to do so. Further, although present at the hearing, Mr. Lira chose not to testify on his own behalf. The

Administrative Law Judge found that, under these circumstances, it was reasonable to take the strongest possible negative inference from petitioner's failure to testify to contradict the Division's case (*see Matter of Drebin v. Tax Appeals Trib.* 249 AD2d 716 [1998]).

The Administrative Law Judge denied the petitions of Huaquechula Restaurant Corporation and Fidel J. Lira.

ARGUMENTS ON EXCEPTION

On exception, petitioners make substantially the same arguments as were raised before the Administrative Law Judge. Petitioners argue that the Division did not follow proper procedures in determining the adequacy of the corporation's records. According to petitioners, by issuing subpoenas for third-party information prior to reviewing the records, the Division prejudged the adequacy of the corporation's records.

Petitioners next argue that the methodology adopted was not reasonably calculated to reflect the proper tax due, but rather to achieve the highest possible tax due.

Petitioners next claim that the estimated audit methodology was not properly utilized and the computations of the head count, average meal price, and capital and expense purchases were inaccurate.

With regard to the Notice of Determination issued to the corporation, petitioners claim that the Division failed to introduce any proof that the notice was mailed by certified or registered mail as required by the Tax Law.

Finally, petitioner Fidel J. Lira claims that the Division failed to conduct an analysis of the responsible officer factors before issuing the Notice of Determination to him, requiring a finding that he was not under a duty to act on behalf of the corporation with regard to the sales tax due.

The Division of Taxation argues that it properly requested the corporation's books and records, and that no records were provided except for some Federal Forms 1120. In the absence of records, the Division states that it attempted to conduct an observation test inside the restaurant but was denied access. The Division states that it was because of the lack of books and records and the inability to do an observation test inside the restaurant that forced the department to do an observation outside of the restaurant. Further, the Division argues that petitioners have failed to establish any errors made in the estimated methodology used or the amount of tax determined to be due. With regard to the mailing issue, the Division notes that petitioner never alleged that the notices were mailed after the date on the notice nor that they were not received. Consequently, the Division urges it was not required to present proof of certified mailing of the notice because the corporation failed to establish a prima facie case in asserting a statute of limitations defense.

Finally, the Division alleges that Mr. Lira never denied that he was a responsible officer, and, the Division points out, he did not testify although present at the hearing. The Division notes that Mr. Lira signed all of the tax returns for the period and checks for the payment of tax. The Division claims that there are sufficient facts in the record to establish Mr. Lira's responsibility for the taxes due and that he failed to meet his burden of proof to demonstrate by clear and convincing evidence that he was not a responsible officer.

OPINION

We address briefly petitioners' argument that the Division did not follow established procedures to determine the accuracy of the corporation's books and records because the Division requested information from third-party suppliers prior to beginning the formal audit. Petitioners urge that these requests indicated that the Division had predetermined that the

corporation's books and records were inadequate. We reject this claim as not based in law. It is also contrary to the facts of this case. The Division made a written request for the corporation's books and records and the corporation provided nothing relating to its sales activity. Petitioners' representative was notified by letter that the failure to provide books and records relating to the corporation's sales would, of necessity, result in the auditor estimating sales. Despite the Division's repeated requests, petitioners failed to provide the books and records. When attempts were made to schedule an observation test of petitioners' sales, the auditor was barred from having access to the premises. Petitioners cannot now complain that the audit is inexact, when any imprecision is of their own making. Under the circumstances presented here, exactness is not required (*see Matter of Markowitz, supra*). We note that petitioners could have provided books and records at the audit, but did not. Further, they could have provided books and records at the hearing in this matter, but did not. Under the circumstances, we find ourselves somewhat bemused by petitioners' claim that the audit lacked precision. As such, petitioners' arguments are rejected. It was petitioners' burden not merely to make arguments against the auditor and the audit method, but to prove by clear and convincing evidence that the assessment was erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842 [1986]) or that the audit method was unreasonable (*Matter of Cousins Serv. Sta.*, Tax Appeals Tribunal, August 11, 1988). Petitioners have done neither. We have reviewed and considered the remainder of petitioners' arguments and find them equally without merit.

The determination of the Administrative Law Judge is affirmed. We find that the Administrative Law Judge considered and correctly decided each of the issues and arguments raised by petitioners. Petitioners offered no evidence below nor arguments on exception that would justify our modifying the determination in any respect.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Huaquechula Restaurant Corp. and Fidel J. Lira is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Huaquechula Restaurant Corp. and Fidel J. Lira are denied; and
4. The Notices of Determination, dated April 30, 2007, are sustained.

DATED:Troy, New York
May 12, 2011

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

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

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