STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
J & L DONUT SHOP, INC.	:	DECISION DTA NO. 823143
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, 2005 through February 28, 2009.	:	

Petitioner, J & L Donut Shop, Inc., filed an exception to the determination of the Administrative Law Judge issued on April 28, 2011. Petitioner appeared by Buxbaum Sales Tax Consulting, LLC (Michael J. Buxbaum, CPA). The Division of Taxation appeared by Mark Volk, Esq. (Robert A. Maslyn, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on March 21, 2012 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 audit methodology utilized by the Division of Taxation in its audit of J & L Donut Shop, Inc. had a rational basis and was reasonably calculated to reflect the taxes due.

II. Whether penalties asserted against petitioner should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "3" and "8." The Administrative Law Judge's findings of fact and the modified findings of fact are set forth below.

Petitioner, J & L Donut Shop, Inc., was established in 1983 and registered to do business in New York State in April 1984. Petitioner operated under the name Galaxy Restaurant, and was located at 1 Palisade Avenue, Yonkers, New York. Its business hours were 6:00 A.M. to 5:00 P.M., Monday through Saturday, and 7:00 A.M. to 3:00 P.M. on Sunday.

On July 31, 2008, the Division of Taxation (Division) sent a letter to petitioner stating that the business's sales and use tax records had been scheduled for a field audit for the period June 1, 2005 through May 31, 2008. 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. Among other things, the letter requested sales invoices, cash register tapes and guest checks for the entire audit period.

We modify finding of fact "3" of the Administrative Law Judge's determination to read as follows:

> On November 25, 2008, the Division's auditor visited the business premises and ordered two items, a muffin and a cup of tea. According to the menu, the muffin cost $1.50 and the tea cost $1.25. The auditor received a guest check showing $3.00 due. The cashier collected the guest check and $3.00, and upon request, the auditor received a receipt showing only the total of $3.00. The receipt did not separate the items purchased into taxable and nontaxable categories, or identify the amount of tax due or the name of the business.[1]

[1] We modify this fact to more accurately reflect the record.

On December 25, 2008, the taxpayer's representative informed the auditor by letter that petitioner was not in possession of original sales invoices or cash register tapes for the audit period. In response, the auditor sent a letter dated January 16, 2009 requesting guest checks, cash register tapes, sales journal, general ledger and purchase invoices for the months of December 2008 and January 2009. In response to the Division's request, petitioner provided to the auditor cash register tapes and guest checks for the period January 8, 2009 through January 28, 2009. The cash register tapes did not detail the items sold and the guest checks did not separately state the tax due or the items sold.

On April 8, 2009, an investigator of the Division entered the business premises and ordered a coffee and a muffin. The guest check listed the two items purchased and the total amount due of $4.35. There was no separate amount charged for each item and no separate statement of the tax due. On April 9, 2009, the investigator purchased for take-out a coffee and muffin and was charged $3.00. The receipts received by the investigator on both days showed only the total collected, with no separately stated tax or business identification.

On April 21, 2009, the Division sent a second letter to petitioner stating that the audit period had been amended and expanded to the period September 1, 2005 through February 28, 2009. The letter stated that, in addition to the records already requested, all books and records pertaining to the sales and use tax liability for the updated period were to be made available. A schedule of books and records to be produced was attached to the letter. Among other things, the letter requested sales invoices, cash register tapes and guest checks for the entire audit period.

Except for the period January 8, 2009 through January 28, 2009, petitioner did not provide any source documentation such as guest checks or cash register tapes, a day book or any type of tax accrual account. The guest checks and cash register tapes that were provided either

did not indicate the items sold, failed to separately state the amount of tax collected, or both. After reviewing the few records provided, the auditor decided to employ an indirect audit method to calculate the amount of taxable sales. The indirect audit method chosen was a rent factor.

We modify finding of fact "8" of the Administrative Law Judge's determination to read as follows:

> The auditor employed an industry index entitled Restaurant Industry Operations Report, 2007-2008 edition, to compute the gross sales of petitioner. The publication contains data on restaurant operations in various categories, was commonly used in the auditor's office, and he was familiar with the use of the index. The index is based on financial and operating data for 2006 provided by members of the National Restaurant Association and members of various state restaurant associations. The data processing contained in the report was performed by Deloitte & Touche, LLP.
>
> The auditor obtained a rent factor of 8.8 percent, representing rent as a percentage of gross sales. This rent factor was the median quartile for limited service restaurants. For the years 2005, 2006 and 2007, the rent factor chosen was applied to the rent amount taken from petitioner's U.S. corporation income tax return, Form 1120. The monthly rent determined to be paid by petitioner as claimed on the returns was $7,898.00 for the year 2005, $7,458.00 for the year 2006 and $7,528.00 for the year 2007. As the auditor did not have in his possession petitioner's U.S. corporation income tax returns for the years 2008 and 2009, he projected the rent claimed to have been paid in 2007 to the last two years. Using the foregoing figures for the audit period, the auditor estimated gross sales of $3,600,414.62, additional taxable sales of $2,632,809.62, and additional sales tax due of $220,497.98.
>
> The auditor did not make an adjustment for nontaxable sales because the auditor did not observe a specific take-out sales area. The restaurant did not appear to be set up for take-out sales. Petitioner had not provided any records of nontaxable sales and the investigator had been charged sales tax on her purchase of a nontaxable item, the muffin for take-out.[2]

Petitioner executed two consents extending the period of limitations for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law that collectively extended the period

[2] We modify this fact to more accurately reflect the record.

in which to assess sales and use taxes due for the period September 1, 2005 through November 30, 2006 to December 20, 2009.

On the basis of the audit performed, the Division issued a Notice of Determination (Assessment # L-032254703-6), dated June 29, 2009, to petitioner, which assessed sales and use tax for the period September 1, 2005 through February 28, 2009 in the amount of $220,497.98, plus penalty and interest. The penalty was imposed pursuant to Tax Law § 1145 (a) (1) because of the inadequacy of the business's records and the amount of the underreporting of tax.

On September 15, 1997, petitioner signed a lease with the then landlord that provided for monthly rent in the amount of $4,200.00 in its last year, 2004. On June 26, 2003, petitioner executed an extension of the lease with a new landlord that provided for monthly rent for each of the fiscal years ended June 30, 2004 through June 30, 2009 of $7,500.00, $7,762.50, $8,034.18, $8,315.38 and $8,606.42, respectively.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge observed the statutes governing sales tax and the standards for reviewing sales tax audits. The Administrative Law Judge determined that the Division made a proper records request and that petitioner failed to produce records sufficient to conduct a complete audit. The Administrative Law Judge noted that, in order to prevail, petitioner must come forward with clear and convincing evidence that the audit methodology was unreasonable. After reviewing the record, the Administrative Law Judge concluded that petitioner failed to establish that the audit methodology was unreasonable. The Administrative Law Judge noted that the auditor estimated petitioner's tax liability using a lower rent than petitioner actually paid and employed a lower rent factor than the amount that correlated to petitioner's business. The Administrative Law Judge rejected petitioner's arguments on exempt

sales because petitioner failed to prove that it did not charge sales tax on exempt sales, and the record shows that petitioner did charge sales tax on exempt sales. Accordingly, the Administrative Law Judge found that the audit methodology was reasonable.

The Administrative Law Judge also observed that, in this case, penalties are statutorily imposed and that petitioner failed to produce sufficient evidence to support the abatement of penalties. Accordingly, the Administrative Law Judge sustained the subject Notice of Determination together with penalty and interest.

ARGUMENTS ON EXCEPTION

Petitioner argues that the determination must be reversed because it is wrong in all respects. Petitioner relies on arguments that are substantially similar to those raised before the Administrative Law Judge. Specifically, petitioner contends that it was unreasonable for the Division to use a rent factor methodology because it could not pay the rent. Petitioner also contends that the audit should be cancelled or adjusted because the Division failed to account for nontaxable sales. Petitioner argues that the Administrative Law Judge inappropriately weighed elements in the record, including testimony from both the auditor and petitioner, as well as petitioner's submissions.

The Division argues that the Administrative Law Judge properly resolved this matter. The Division notes that petitioner does not dispute the inadequacy of the records, and that the primary issue in this matter is whether the audit methodology and resulting assessment were reasonable. The Division contends that the rent factor is a reasonable methodology, and that its figures produced a lower estimate than an audit based on petitioner's figures. The Division argues that an adjustment for tax exempt sales is not appropriate because petitioner did not have a take-out area and imposed sales tax on a nontaxable sale. The Division notes that petitioner did

not introduce any suitable records to the contrary. The Division also argues that penalties are statutorily imposed and that petitioner did not establish grounds for abatement.

OPINION

This Tribunal has well-established standards for reviewing sales tax audits. As summarized in ***Matter of AGDN, Inc***. (Tax Appeals Tribunal, February 6, 1997):

> "[A] vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (***see***, Tax Law §§ 1138[a]; 1135; 1142[5]; ***see***, ***e.g.***, ***Matter of Mera Delicatessen***, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . .' (Tax Law § 1138[a]; ***see, Matter of Chartair, Inc. v. State Tax Commn.***, 65 AD2d 44, 411 NYS2d 41, 43).
>
> When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (***Matter of Grant Co. v. Joseph***, 2 NY2d 196, 159 NYS2d 150, ***cert denied*** 355 US 869); exactness is not required (***Matter of Meyer v. State Tax Commn***., 61 AD2d 223, 402 NYS2d 74, ***lv denied*** 44 NY2d 645, 406 NYS2d 1025; ***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023, 388 NYS2d 176, ***affd*** 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451)."

Having reviewed the appropriate standards, we now address the instant audit.

Petitioner did not provide the requested books and records for the audit period. As such, we find that the Division properly determined that petitioner failed to meet its statutory obligations under the Tax Law. Therefore, we conclude that the Administrative Law Judge properly determined that the Division was entitled to estimate petitioner's tax liability using an indirect audit methodology.

Initially, we note that the Division may estimate sales tax liability based on petitioner's rent. The Tax Law provides the Division with the discretionary authority to use any method that reasonably calculates the amount of tax due (***Matter of Surface Line Operators Fraternal Org. v Tully***, 85 AD2d 858 [1981]). "[W]here the taxpayer's own failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required" (***Matter of Meyer v State Tax Commn.***, 61 AD2d 223, 228 [1978], ***lv denied*** 44 NY2d 645 [1978]). As germane herein, the Courts have held that it is appropriate to conduct a sales tax audit based on the taxpayer's rent (***see e.g. Matter of Bitable on Broadway, Inc.,*** Tax Appeals Tribunal, January 23, 1992, ***confirmed sub nom. Matter of Bitable on Broadway v Wetzler***, 199 AD2d 633 [1993]). In order to prevail,

> "the taxpayer has the burden of overcoming a deficiency assessment by clear and convincing evidence showing that both the method used to arrive at the assessment and the assessment itself are erroneous" (***Matter of Giuliano v Chu***, 135 AD2d 893, 895 [1987]; Tax Law § 689).

We affirm the determination of the Administrative Law Judge.

In the instant matter, the index used to estimate petitioner's sales was generated from data provided by petitioner. For the years 2005, 2006 and 2007, the Division utilized the amount of rent paid by petitioner as reported on its Forms 1120. As it did not have petitioner's Forms 1120 for the years 2008 and 2009, the Division utilized the estimated figure from 2007, which was lower than the amount of monthly rent petitioner purportedly paid during those years. Petitioner appeared to operate a full service restaurant; however, the Division construed the business as a limited service restaurant and used a lower rent factor percentage. We note that these elements inured to petitioner's benefit because they resulted in a lower estimated tax liability. Based on

the foregoing, we conclude that the Administrative Law Judge properly determined that the Division utilized a reasonable audit methodology and arrived at a reasonable assessment.

Petitioner's arguments challenging the audit methodology and assessment are not sufficiently supported by the record. These arguments are premised upon the position that the rent paid by petitioner has no relationship to petitioner's sales. In order to prevail on this line of reasoning, a taxpayer must establish sales with source documentation, such as guest checks, receipts, cash register tapes, etc. (Tax Law § 1135; ***see e.g. Matter of Goldner v State Tax Commn.***, 70 AD2d 978 [1979], ***lv denied*** 48 NY2d 608 [1979]). While petitioner introduced an unsorted summary of sales for a period, a summary is not source documentation and fails to substantiate sales for any period of the audit. Petitioner's sales cannot be determined and, therefore, it is impossible to clearly and convincingly establish whether the assessed amount is unreasonable (***see e.g. Matter of Nicholls v State Tax Commn.***, 101 AD2d 950 [1984]). Therefore, we conclude that petitioner has not established that either the audit methodology or the assessment was unreasonable.

We also find that the record does not support adjustments to the assessment for petitioner's purported nontaxable sales. During its audit, the Division found that petitioner did not have a specific take-out area and that petitioner did, in fact, charge sales tax on a take-out purchase. Petitioner was provided opportunities to counter this point. The record shows that on audit, the Division requested that petitioner provide evidence of its nontaxable sales. At the hearing, petitioner was provided with further opportunity to introduce source documentation showing that a percentage of its sales were tax exempt. Under these circumstances, we note that cancellation is not the appropriate remedy. Upon a showing of non-fatal error, adjustments to the assessment would be the appropriate remedy (***see e.g. Matter of Berstein-On-Essex St.***, Tax

Appeals Tribunal, December 3, 1992). However, the burden rests with the taxpayer to develop the record and establish the existence of nontaxable sales during the audit periods. In this matter, petitioner failed to introduce any proof or evidence regarding exempt sales. Absent such evidence, the record does not support an adjustment. Therefore, we conclude that the Administrative Law Judge properly rejected petitioner's arguments regarding exempt sales.

We find that the Administrative Law Judge properly determined that petitioner failed to establish reasonable cause for the abatement of penalties. Additionally, we find no merit to petitioner's challenges to the Administrative Law Judge's determinations of credibility because these arguments lack support. We further find that petitioner's remaining arguments merit no further discussion as they have been properly rejected by the Administrative Law Judge.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of J & L Donut Shop, Inc. is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petition of J & L Donut Shop, Inc. is denied; and
4. The Notice of Determination dated June 29, 2009 is sustained.

DATED: Albany, NY
September 13, 2012

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

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