

STATE OF NEW YORK  
DIVISION OF TAX APPEALS

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In the Matter of the Petitions :  
of :  
WEST MARKET DINER, INC., :  
AND MARVIN ZELIN AND ASHER ZELIN :  
AS OFFICERS OF WEST MARKET DINER, INC. :  
for Revision of Determinations or for Refunds :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period March 1, 1979 :  
through November 30, 1982. :  
: DETERMINATION

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In the Matter of the Petitions :  
of :  
MARKET DINERS, INC., :  
AND MARVIN ZELIN, MURRAY ZELIN AND :  
IRVING ZELIN, AS OFFICERS OF :  
MARKET DINERS, INC. :  
for Revision of Determinations or for Refunds :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period December 1, 1978 :  
through November 30, 1982. :

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Petitioner West Market Diner, Inc., 256 West Street, New York, New York 10013, filed a petition 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, 1979 through November 30, 1982 (File No. 801001).

Petitioners Marvin Zelin, 356 Derby Avenue, Woodmere, New York 11598, and Asher Zelin, 256 West Street, New York, New York 10013, as officers of West Market Diner, Inc., each filed a petition 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, 1979 through November 30, 1982 (File Nos. 800980 and 800978).

Petitioner Market Diners, Inc., 411 Ninth Avenue, New York, New York 10001, filed a petition 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 December 1, 1978 through November 30, 1982 (File No. 801000).

Petitioners Marvin Zelin, 356 Derby Avenue, Woodmere, New York 11598, Murray Zelin, 17A Bedfordshire Drive, Cranbury, New Jersey 08512 and Irving Zelin, 219 Brightwater Court, Brooklyn, New York 11235, as officers of Market Diners, Inc., each filed a petition 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 December 1, 1978 through November 30, 1982 (File Nos. 800979, 800976 and

800977).

A consolidated hearing was commenced before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on June 9, 1987 at 9:50 A.M. and was continued to conclusion before the same Hearing Officer at the same location on August 5, 1987 at 9:40 A.M., with all briefs to be submitted by November 30, 1987. Petitioners appeared by Goldfinger & Lassar, Esqs. (Stephen D. Lassar, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Michael Gitter, Esq., of counsel).

### ISSUES

I. Whether assessments of sales and use taxes issued against the petitioner corporations, following an Audit Division field audit, were proper as to methodology and result and should be sustained.

II. Whether, if so, the petitioner corporations have nonetheless established any basis warranting abatement of penalties imposed for failure to have remitted sales and use taxes due.

III. Whether petitioners Marvin Zelin, Asher Zelin, Murray Zelin and Irving Zelin were persons required to collect sales tax on behalf of the petitioner corporations within the meaning and intent of Tax Law §§ 1131(1) and 1133(a).

### FINDINGS OF FACT

1. On December 20, 1983, following a field audit, the Audit Division issued to the entities and individuals<sup>1</sup> listed below the following notices of determination and demands for payment of sales and use taxes due for the periods and in the amounts indicated, together with penalty and interest. It is undisputed that each of these notices of determination were timely issued pursuant to a series of validated consents extending the period of limitations on assessment, the latest of which allowed assessment to occur for the periods in question at any time on or before December 20, 1983. The notices are as follows:

<u>ISSUED TO</u>	<u>PERIOD</u>	<u>TAX AMOUNT<sup>2</sup></u>
West Market Diner, Inc.	3/1/79-8/31/82	\$61,878.90
West Market Diner, Inc.	9/1/82-11/30/82	4,423.74
Asher Zelin	3/1/79-8/31/82	60,784.36

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<sup>1</sup>The notices issued to the four named individuals are so issued upon the premise that such individuals were officers responsible to collect sales tax on behalf of the corporate entities.

<sup>2</sup>The tax amounts shown are exclusive of penalty (Tax Law former § 1145[a][1]) and interest.

Asher Zelin	9/1/82-11/30/82	4,388.55
Marvin Zelin	3/1/79-8/31/82	60,784.36
Marvin Zelin	9/1/82-11/30/82	4,388.55
Market Diners, Inc.	12/1/78-5/31/82	65,756.89
Market Diners, Inc.	6/1/82-11/30/82	9,260.12
Marvin Zelin	12/1/78-5/31/82	65,126.47
Marvin Zelin	6/1/82-11/30/82	9,213.01
Murray Zelin	12/1/78-5/31/82	65,126.47
Murray Zelin	6/1/82-11/30/82	9,213.01
Irving Zelin	12/1/78-5/31/82	65,126.47
Irving Zelin	6/1/82-11/30/82	9,213.01

2. The dollar amounts shown on the above notices of determination issued against the corporate entities may be more specifically broken down as follows:

(a) West Market Diner

Use tax on expense purchases	\$ 527.73
Use tax on fixed assets	602.00
Sales tax on overcollections	3,376.99
Parking tax	944.70
Sales tax on food & beverage sales	<u>60,851.22</u>
Total	<u>\$66,302.64</u>

(b) Market Diners, Inc.

Use tax on expense purchases	\$ 450.48
Use tax on fixed assets	227.05
Sales tax on overcollections	1,852.47
Sales tax on food & beverage sales	<u>72,487.01</u>
Total	<u>\$75,017.01</u>

The dollar differences between the amounts assessed against the corporate petitioners versus the amounts assessed against the individual petitioners result from the fact that use tax on expense purchases and on fixed assets was not assessed against the individual petitioners.

3. It was conceded at hearing that Asher Zelin and Marvin Zelin were persons required to collect sales tax on behalf of West Market Diner, Inc. and that Marvin Zelin, Murray Zelin and Irving Zelin likewise were responsible for the collection of sales tax on behalf of Market Diners, Inc. Accordingly, the only remaining issue herein is the propriety of the sales and use tax assessments (with attendant penalties) issued after the field audit conducted with respect to the corporate petitioners.

4. During the respective periods in issue petitioners West Market Diner, Inc. ("West") and Market Diners, Inc. ("Market") each operated railroad car-style diners. The diners were open 7 days per week and 24 hours per day. Although not entirely clear from the record, it appears the petitioner corporations filed their sales and use tax returns by computing taxable sales based upon an estimate of taxable to nontaxable sales in accordance with a taxable ratio determined upon a prior audit (i.e.\_\_\_\_, application of estimated taxable percentage to gross sales).

5. In or about March of 1982, the Audit Division commenced a sales and use tax field audit of the operations of the corporate petitioners, West and Market. The auditor requested by letter that these petitioners produce records of their business operations, specifically those records related to the calculation of sales and use tax liabilities. Petitioners provided cash receipts journals, check disbursements journals and general ledgers for the audit period, as well as cancelled checks and monthly bank statements. However, guest checks and cash register tapes were not available per request at the time of audit, and it is undisputed that neither guest checks nor cash register tapes were retained by petitioners for the periods under audit. Further, although guest checks are used at both diners, they are not always used for each sale, nor are those guest checks used accounted for thereafter in sequential order.

6. Petitioners noted that at the end of each business day, each diner's summary cash register tapes were transcribed into a daily book. However, based upon the unavailability of either sequentially-numbered guest checks or cash register tapes, and notwithstanding the aforementioned transcription into and maintenance of a daily book of summary receipts, the auditor determined petitioners' records to be inadequate for purposes of conducting a detailed audit and determined it was appropriate to utilize indirect audit methodologies in an attempt to verify the correctness of petitioners' sales and use tax returns as filed.

7. As noted in Finding of Fact "2" the auditor found certain (comparatively small) amounts of tax due on a number of items, including use tax on expense purchases and fixed assets, as well as parking tax and sales tax on overcollections. At hearing, these amounts were conceded by petitioners as due and owing and are not challenged or at issue in this proceeding. Accordingly, the major portion of the assessments herein, representing sales tax determined to be due on food and beverage sales, together with the related issue of the appropriateness of assessing a penalty, are the only items remaining for determination in this proceeding.

8. The Audit Division first performed an "observation test" of the operation of West and Market. Two separate eight-hour days of observation were used for each diner, specifically the dates of September 10 and 14, 1982 for West and January 19 and 22, 1982 for Market. Certain of the sales observed at each diner were noted as nontaxable (e.g.\_\_\_\_, sales of cold cuts by the pound and of bakery goods for off-premises consumption). The results of the observation tests were thereafter projected forward based on the number of days and hours the diners were open (taking into account in such projection the nontaxable percentage of sales observed at each diner and adjusting the results for inflation increases each year). These projections were compared to each diner's sales and use tax returns with the result being a determination that each diner owed additional tax.

9. The results of the observation tests were reviewed with petitioners and their representatives, at which time a number of disagreed items were discussed. In the course of the review, it was agreed between petitioners and the Audit Division that a re-audit would be undertaken utilizing a "markup" audit methodology, specifically involving a test period of purchase invoices for September 1982, together with selling prices from a September 1982 menu. Accordingly, utilizing West's September 1982 purchase invoices and the prices in effect per a September 1982 menu, the Audit Division performed a "main item" markup audit.

10. In brief, this main item markup audit methodology involves finding the "main item" on a given dinner platter (e.g.\_\_\_\_, steak on a steak platter) and finding a comparable purchase of such a main item per the purchase invoices. A per portion (per platter) amount of such item is determined and, after allowance for trimming and shrinkage, the number of portions available from the amount of the main item purchased (per the purchase invoices) is calculated. The total

number of portions thus available is multiplied by the selling price of the platter (per the menu) to arrive at a sales receipts figure for such main item purchased. This procedure is followed for each main item purchased such that, after all comparisons are made in this manner, a gross sales figure is arrived at for the test period. Thereafter total purchase costs (per purchase invoices) are subtracted from gross sales (for the test period) to arrive at gross profit. In turn, gross profit is divided by cost of goods purchased to yield a markup percentage. It is noted that no specific cost or markup is attached to items on a given platter other than the main item, with the cost of such other items being deemed included in the selling price of the total platter.

11. The Audit Division followed this methodology in general and applied the markup derived for the test period to petitioner West's purchases for the entire audit period to arrive at gross sales. Thereafter, an allowance reducing gross sales was made to reflect employee meals, specifically at the rate of two meals per day per employee (with the number of employees calculated per West's payroll information) at \$4.00 per meal. The employee meal allowance was reduced for each year from 1981 back through 1979 at the rate of 9 percent per year, stated by the auditor to be a factor calculated to give cognizance to inflation. Gross sales were also reduced by nontaxable sales based on the percentage of nontaxable sales determined per the prior observation test (26.274 percent nontaxable), and audited taxable sales resulted. Comparison was then made between audited taxable sales and reported taxable sales and a differential in tax equal to \$60,851.22 was determined.

12. The main item markup described above resulted in a markup percentage for West of 217.558 percent over cost. In computing the number of platters to be derived out of the amount of main items purchased, the auditor allowed for shrinkage, trimming and waste by increasing the portion size per platter (rather than by allowing a shrinkage percentage per se).

13. In addition to calculating tax due, the auditor recommended that penalty pursuant to Tax Law former § 1145(a)(1) be added in that, in her opinion, there was no reasonable cause shown by the taxpayer for the abatement of penalty. The auditor's choice of increasing portion size as a means of allowing for shrinkage and trimming, rather than estimating shrinkage and trimming and then figuring portion size, was to make one mathematical calculation instead of two. The actual estimate of portion size (pre-shrinkage) was based on the auditor's experience and the experience of her supervisor, and also on the basis of reference to Audit Division standard shrinkage charts. Assumptions inherent in the auditor's calculations included the assumption that all cheese purchased was sold in sandwiches (the auditor noted there was no basis to differentiate between cheese types as to main items), and the assumption that one-half of the eggs purchased were used other than as main items (e.g.\_\_\_\_, in cooking, baking, etc.).

14. With respect to petitioner Market, the Audit Division applied the same markup as was determined on the audit of West against Market's purchases for the audit period. Similarly, the same employee meal allowance, including the 9 percent factor reducing said allowance for inflation, was used. In addition, an allowance was made for nontaxable sales based on the results of the prior observation test of Market (specifically 22.01 percent of sales).

15. The auditor applied the markup determined on West to Market on the bases that the diners were both part of a series of family-owned diners, had the same style and method of operation, were open the same number of days and hours, and were lacking the same records deemed requisite for the conduct of a complete, detailed audit. In addition, use of the same markup was deemed appropriate and necessary because the Audit Division although obtaining menus from Market was unable, despite requests, to secure a menu from Market dated for September 1982. The auditor also alleged that use of West's markup upon Market was, at least

tacitly, agreed to by petitioner Market's representatives. Similarly, penalty pursuant to Tax Law § 1145(a)(1) was imposed based upon the auditor's belief that reasonable cause for abatement thereof had not been shown.

16. Included in evidence were comparative figures as to each of the Diners' sales, cost of goods sold and resultant gross profit percentages as taken from their United States Corporation Income Tax Returns, as well as menus from each of the diners. Review of these various documents reveals differences between the diners both as to their respective menu prices as well as their profit percentages.

### SUMMARY OF PETITIONERS' POSITION

17. At hearing, petitioners' principals appeared and testified that in their opinion the Audit Division's audit results were flawed in a number of areas. Petitioners first allege that the allowance for employee meals was understated. In this respect, petitioners estimated an appropriate employee meal allowance would be \$10.12 per day for West and \$9.75 per day for Market rather than the \$8.00 at each diner as allowed by the Audit Division. Further, petitioners allege error in that the auditor did not allow large enough portion sizes and, in effect, did not allow an adequate shrinkage and trimming rate. Finally, petitioners argue that the auditor did not allow for breakfast specials, and made no allocation of petitioners' meals on the basis of sandwiches versus platters. In this latter vein it is asserted that, in general, 80 percent of petitioners' sales were sales of sandwiches and only 20 percent were sales of platters. Lastly, petitioners assert that since Market is a smaller diner than West, it is inappropriate to apply to Market the same markup percentage as was derived for West. More specifically, petitioners assert that lower selling prices in effect at Market resulted in a markup percentage for Market which was on average 7.5 percent lower than the markup at West. Petitioners do not contest, in general, the application of West's audit results to Market, but rather assert that the amount of the markup (percentage) should be reduced to reflect the difference in markup at the respective diners.

18. Petitioners presented certain schedules at hearing reflecting a reconstruction of the audit results based upon most of the purchase invoices used by the auditor, coupled with estimates by petitioners' principals as to shrinkage and portion sizes and an allocation between sandwiches and platters. This recalculation by petitioners reaches the result and conclusion that no tax was due and that petitioners' returns, as filed, were correct.

19. With respect to the imposition of penalties, petitioners seek abatement upon the basis of their prior audit history, to wit, that any prior deficiencies were based upon errors in petitioners' taxable ratio and not upon any deficiency found as to reporting of gross sales. Petitioners argue first that there should be no deficiency and, even if there is a deficiency, it is not based upon the same error as in the prior audit since here there was no challenge to petitioners' taxable to nontaxable ratio.

### CONCLUSIONS OF LAW

A. That Tax Law § 1138(a) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined from such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices.

B. That resort to the use of a test period to determine the amount of tax due must be based upon an insufficiency of recordkeeping which makes it virtually impossible to determine such liability and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44). In this case, petitioners did maintain certain books and records, as described, which were made available to the Audit Division (see Finding of Fact "5"). These records, however, were insufficient for verification of taxable sales since a record of each individual sale, as required pursuant to Tax Law § 1135 and companion regulations (see 20 NYCRR 533.2), was not retained by petitioners. Most specifically, no guest checks were available for the period in question. Petitioners would excuse the absence of this necessary record by alleging a lack of storage space in which to maintain/retain such records. However, the difficulty in retaining a necessary record does not obviate its requirement or, more importantly, does not alter the fact that the lack of such a record in this case makes it virtually impossible to conduct a complete audit. Accordingly, the Audit Division's determination to resort to the use of external indices and indirect audit methodologies was proper.

C. That in determining the amount of a sales tax assessment, it is the duty of the Audit Division to select a method "reasonably calculated to reflect the taxes due" (see Matter of Grant Co. v. Joseph, 2 NY2d 196, 206, cert denied 355 US 869). When the Audit Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 227, lv denied 44 NY2d 645). In this case, the Audit Division used an observation test first and, subsequently at petitioners' request, re-audited based upon a markup audit method. Given the lack of records as described, and noting that petitioners themselves requested the re-audit using a markup method, the use thereof is clearly accepted as a reasonable method.

D. That, in general, petitioners have not established by clear and convincing evidence that the amount of tax assessed by the Audit Division upon audit was incorrect (see Surface Line Operator's Fraternal Organization v. Tully, 85 AD2d 858). In this regard, it is noted that petitioners' assertions center upon allegations of errors in audit estimates as to portion size, shrinkage and trimming, which allegedly erroneous estimates would be supplanted by estimates of petitioners' principals. Such estimates, however, are supported at best by scant other evidence, and do not appear patently more reasonable than those utilized by the Audit Division. In addition, without presentation of records, there is no sufficiently reliable or verifiable basis established from which an allocation can be made between sandwiches and platters. It is noted with respect to this type of audit that exactness is not required when it is petitioners' own failure to maintain proper records which prevents exactness in the determination of sales tax liability (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, affd 44 NY2d 684). The inexactnesses alleged herein, resulting from petitioners' own failure to have maintained necessary records, must weigh against petitioners (see Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943).

E. That notwithstanding the foregoing, however, on a specific basis certain adjustments to the audit are appropriate. First, the reduction of the estimate of employee meal allowance by 9 percent per year to reflect inflation is to be eliminated. There has been no showing that menu prices in fact increased each year, that 9 percent is appropriate as the rate of inflation during any of the years in question, or that such 9 percent factor was based upon any particular index, external or otherwise. Additionally, based upon a comparison of menus and Federal income tax returns for both corporate petitioners, together with additional factors such as diner location, competition and availability of parking, petitioners have established that the markup at Market was, as asserted, on average 7.5 percent less than the markup at West. Thus, application of the markup from West to Market is to be adjusted accordingly.

F. That the imposition of penalty herein was appropriate and is sustained. Petitioners not only failed to retain necessary records from which their exact liability could have been determined, but also chose to compute their liability and file their returns based essentially on estimates, thus running the risk that a substantial underpayment would be determined upon audit and that penalties would be imposed as a result thereof.

G. That the petitions of West Market Diner, Inc. and Market Diners, Inc., and of Marvin Zelin, Asher Zelin, Murray Zelin, and Irving Zelin, as officers (whose individual liability for any amounts held due was conceded), are granted to the extent indicated in Conclusion of Law "E", but are otherwise denied, and the notices of determination and demands for payment of sales and use taxes due issued December 20, 1983, as modified in accordance herewith, are sustained.

DATED: Albany, New York  
May 12, 1988

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/s/  
ADMINISTRATIVE LAW JUDGE