

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
RALPH SCOTTO, OFFICER OF	:	DETERMINATION
WATERSET ENTERPRISES, INC.	:	
T/A HARBOR CLUB RESTAURANT	:	
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, 1982	:	
through August 31, 1985.	:	

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Petitioner, Ralph Scotto, officer of Waterset Enterprises, Inc. t/a Harbor Club Restaurant, 57 Coleridge Street, Brooklyn, New York 11235, 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, 1982 through August 31, 1985 (File No. 803698).

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on February 28, 1990 at 9:45 A.M. with all briefs to be filed by August 3, 1990. Petitioner appeared by Jerome Schwartz, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUES

- I. Whether the filing of a bankruptcy petition by a corporation bars the Division of Taxation from proceedings to collect tax against petitioner, an officer of that corporation.
- II. Whether the Division of Taxation properly determined that additional sales and use taxes are due.

FINDINGS OF FACT

Waterset Enterprises, Inc. t/a Harbor Club Restaurant ("Harbor Club") was a restaurant located in a busy downtown area. A small reservation desk was located at the right of the entrance to the restaurant. On the left side of the restaurant there was a bar area with tables and

stools. A dining room with approximately 40 tables for seating patrons was located behind the bar. The main dining room, which contained approximately 100 tables for seating patrons, was on the right side of the restaurant. A balcony, located across from the main dining room, contained an additional 18 to 20 tables.

On May 30, 1985, the Division of Taxation mailed a letter to the Harbor Club which stated that its New York State sales tax returns for the period December 1, 1982 through February 28, 1985 had been selected for an audit. The letter scheduled the audit at 10:00 A.M. on June 12, 1985 and requested that the corporation have available for the audit the following documents: copies of the 1982 and 1983 Federal tax returns, copies of the last nine sales tax returns and cancelled checks as proof of payment, documentation to support claimed exempt sales, worksheets for preparing the sales tax returns for the period December 1, 1982 through February 28, 1985, bank statements for the last six quarters of the audit period, and sales and purchase journals for the period December 1, 1982 through February 28, 1985. On May 31, 1985 Harbor Club's representative requested a postponement. In response, the initial appointment was rescheduled to June 24, 1985. On June 19, 1985 Harbor Club's accountant again requested that the appointment be rescheduled. Consequently, a new appointment was scheduled for July 8, 1985 at 9:30 A.M. On July 3, 1985 the corporation's accountant called and said that he did not have the corporation's books and records for the scheduled audit. He then acquiesced in the issuance of an assessment.

Since no books and records were provided, the auditor relied on information that the Division had obtained from the Internal Revenue Service. This information was that for the fiscal year ended June 1983 the corporation's Federal corporate income tax return reported that it had sales of \$1,302,425.00. During the same period of time the Harbor Club's New York State sales and use tax returns reported sales in the amount of \$939,336.00. The Division divided the difference in sales of \$363,089.00 by the sales reported to New York State of \$939,336.00 and obtained an error rate of 38.65 percent. Thereafter, the Division multiplied the amount of sales reported on the corporation's sales and use tax returns by the error rate in order to determine that

the Harbor Club had additional taxable sales in the amount of \$899,091.00. The amount of tax due was determined by multiplying the amount of additional taxable sales by the tax rate.

On the basis of the foregoing audit, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner, Ralph Scotto. The notice, which was dated April 28, 1986, assessed sales and use taxes for the period December 1, 1982 through February 28, 1985 in the amount of \$74,175.01 plus penalty of \$17,587.38 and interest of \$23,916.92 for a total amount due of \$115,679.31.

In the course of the audit, the Division ascertained that the corporation did not remit any tax with the sales and use tax return which was filed for the quarterly period ending August 31, 1985. As a result, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due dated April 28, 1986 to petitioner which assessed sales and use taxes for the period June 1, 1985 through August 31, 1985 in the amount of \$9,975.41 plus penalty of \$1,097.30 and interest of \$748.10 for a total amount due of \$11,820.81.

Each of the foregoing notices explained that as an officer, petitioner was personally liable for the taxes determined to be due from the corporation.

In or about November 1982, Mr. Scotto and his associates purchased the stock of Waterset Enterprises. Mr. Scotto obtained 20 percent of the stock and held the office of vice-president. In this position, Mr. Scotto dealt with the immediate management needs of the restaurant and hired and fired personnel at the restaurant. Mr. Scotto was a signatory on the corporation's operating account and payroll account. He signed the corporation's sales and use tax returns, franchise tax returns and payroll reporting documents. Mr. Scotto received a salary from the Harbor Club for the services he performed.

When Mr. Scotto and his associates originally acquired the restaurant, there was a period of time when it was not allowed to conduct sales. Therefore, the receipts from sales were given to the landlord who, in turn, disbursed the funds to suppliers. This situation continued until early 1983 when the Harbor Club obtained a liquor license.

When the Harbor Club began operating, it performed the purchasing function for other

businesses. Harbor Club was able to perform this service because it had storage space available. The larger volume of its purchases enabled the Harbor Club to obtain price discounts. It also received preferential treatment in the quality of its merchandise. As compensation for its purchasing services, the Harbor Club received either repayments, merchandise or labor services from the other firms.

The Harbor Club had a controller who maintained records of the daily sales. These records were provided to the restaurant's accountant for the preparation of its sales tax returns.

At the end of January 1985, Mr. Scotto acquired all of the outstanding stock of Waterset Enterprises.

At the hearing, the Harbor Club's accountant testified that in June 1983 it and certain related corporations examined their financial position. The examination showed that the Harbor Club had an operating profit while two other entities, which were formed at the same time, had losses. Therefore, the principals of the corporations decided to file a consolidated return so that there would be no corporate income taxes due.

The Harbor Club's accountant explained that for the fiscal year ended June 1, 1984 the same corporations again filed consolidated Federal income tax returns. For the following tax periods, the corporations decided to be treated as small business corporations under Subchapter S of the Internal Revenue Code and filed separate returns.

In or about December 1985, Waterset Enterprises filed a petition for bankruptcy.<sup>1</sup> Thereafter, Waterset Enterprises' landlord padlocked the restaurant with the property of the Harbor Club left inside including the records of the Harbor Club.

The Harbor Club never filed a final sales and use tax return because it was denied access to its records. The Harbor Club's accountant no longer has access to his copies of the tax returns which have been filed

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<sup>1</sup>The record does not disclose the current status of the bankruptcy proceeding.

because his office has moved and, as a result, some records have been misplaced, some have been thrown away and some are in storage.

At the hearing, petitioner's representative was given time to obtain and submit copies of the combined Federal returns to document and substantiate his testimony. These documents were never provided.

#### CONCLUSIONS OF LAW

A. Initially, it is petitioner's position that as long as the bankruptcy proceeding involving the corporation is pending, any action against an officer of the corporation is premature. This argument is without merit. The corporation's filing for bankruptcy does not relieve petitioner of his personal liability for the taxes, penalty and interest which have been assessed (see, Matter of Hanellin School Photography, State Tax Commn., July 15, 1983; Matter of Joseph Bressner, State Tax Commn., June 19, 1981). Consequently, the corporation's filing for bankruptcy has no relevance to the liability at issue herein.

B. Petitioner next argues that the calculation of additional tax due is faulty. First, petitioner maintains that the Division should not have relied upon a transmittal from the Internal Revenue Service. Rather, petitioner submits that the Division should have utilized the underlying documents.

C. Section 1138(a) of the Tax Law provides that if a return required to be filed is incorrect or insufficient, the Commissioner of Taxation and Finance shall determine the amount of tax due 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. The Division's use of external indices is proper where, as here, a taxpayer does not have the records necessary to verify taxable sales (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552).

D. Petitioner has failed to prove that the audit method was erroneous. Since petitioner was unable to present any books and records for audit, it was reasonable to assess tax based on reported gross receipts for Federal income tax purposes because Tax Law § 1132(c) presumes the taxability of all receipts. There is no requirement that the Division examine the actual

returns as opposed to a transmittal from the Internal Revenue Service.

E. Petitioner's attack on the audit result centers first upon his contention that 1983 was a short taxable year and therefore its use resulted in an erroneous margin of error.

Initially, it is noted that when the Division uses an indirect audit method, it is required to select an audit method which is reasonably calculated to reflect the tax due (Matter of Grant Co. v. Joseph, 2 NY2d 196, 204, 159 NYS2d 150, 157 cert denied 355 US 869). When the Division selects such an audit method, a presumption of correctness attaches to the assessment (Matter of Cousins Service Station, Tax Appeals Tribunal, August 11, 1988) and petitioner bears the burden of proving error (Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113) by clear and convincing evidence that the method of audit or the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858, 446 NYS2d 451).

Petitioner's argument must be rejected. Since the auditor compared comparable periods of time, no basis has been presented to conclude that the use of a short taxable year resulted in an erroneous margin of error.

F. Petitioner's remaining argument is that the margin of error was erroneous because it compared the sales of the Harbor Club with the combined sales of the Harbor Club and two other entities.

As noted earlier, petitioner's representative was given time to obtain and submit copies of the combined Federal returns to document and substantiate his testimony. Inexplicably, these documents were never provided. Under these circumstances, petitioner's contention, which rests solely on the accountant's testimony, is insufficient to meet petitioner's burden of proof.

G. The petition of Ralph Scotto, officer of Waterset Enterprises, Inc. t/a Harbor Club Restaurant, is denied and the notices of determination and demands for payment of sales and use taxes due, dated April 28, 1986, are sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE