

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
ROBERT TRUSTNOVEC : DETERMINATION
D/B/A YAPHANK COMMUNITY SHOP :
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 June 1, 1981 :
through November 30, 1986. :

Petitioner, Robert Trustnovec d/b/a Yaphank Community Shop, Main Street, Yaphank, New York 10017, 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 June 1, 1981 through November 30, 1986 (File No. 805982).

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 7, 1989 at 9:30 A.M., with all briefs to be submitted by January 10, 1990. Petitioner appeared by Stanley Blacker, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Angelo Scopellito, Esq., of counsel).

ISSUE

Whether, upon field audit, the Division of Taxation properly concluded that petitioner owed additional sales and use taxes.

FINDINGS OF FACT

On June 1, 1987, following a field audit, the Division of Taxation issued to petitioner, Robert Trustnovec d/b/a Yaphank Community Shop, three notices of determination and demands for payment of sales and use taxes due for the period spanning June 1, 1981 through November 30, 1986. Two of these notices assessed tax due for the noted period in the aggregate amount of \$103,523.40, plus penalty (Tax Law § 1145[a][1][i]) and interest. The

third such notice assessed additional "omnibus" penalty (Tax Law § 1145[a][1][vi]) for the period June 1, 1985 through November 30, 1986. The record reveals that validated waivers extending the statute of limitations on assessment had been executed such that the timeliness of the notices of determination described herein is not at issue. In this regard, it is noted that sales tax returns had not been filed for the period June 1, 1981 through February 28, 1983 until all such returns were filed in April of 1983, and that returns for June 1, 1985 through August 31, 1986 were filed at various times in 1986.

Petitioner owns and operates as a sole proprietorship a delicatessen located on Main Street in Yaphank, New York. Petitioner has owned and operated this business since 1970. The store facility contains a counter with four stools, plus 6 tables with 3 chairs at each thus providing an interior seating capacity of 22 people. In addition, six outside picnic tables seat (approximately) an additional 36 people. Sales of merchandise consist principally of delicatessen meats and salads, as well as cigarettes, soda, beer, other prepared foods, newspapers, magazines, and a comparatively small amount of grocery items.

On October 15, 1985, the Division issued to petitioner a letter indicating that petitioner's sales tax returns "for the period June 1, 1981 to date" (i.e. through October 15, 1985) would be subject to a field audit. This letter indicated that petitioner should have available for examination all books and records pertaining to sales tax liability, specifically including "income tax returns, journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records." A subsequent letter dated December 11, 1985 indicated an audit appointment date of January 8 and 9, 1986 at 9:30 A.M. and listed the audit period as "June 1, 1981 through the present" (i.e. through December 11, 1985). This follow-up letter provided the same specifics as to those records the Division would expect petitioner to have available for examination. The record reveals that subsequent correspondence between petitioner and the Division, from the date of these first letters through and beyond the end of the audit period, resulted in an audit period which spanned, as noted, June 1, 1981 through November 30, 1986. In fact, the last of the noted letters between the Division of Taxation and

petitioner, dated March 25, 1987, specifically notes an audit period of June 1, 1981 through November 30, 1986 and schedules an audit appointment for April 9, 1987.

On the initially scheduled audit dates of January 8 and 9, 1986, petitioner met with the Division's auditor and gave the auditor permission to review and utilize certain of petitioner's records which were in the possession of Division income tax auditors in connection with a then-ongoing income tax audit. Those records provided pursuant to this permission included copies of a "receipts and disbursements journal" for 1983 as well as Federal Schedule C ("Profit or [Loss] from Business or Profession") for the years 1981, 1982 and 1983. No additional records were supplied at such time. Shortly thereafter, on January 15, 1986, petitioner was requested to provide more complete and current records. Despite this additional request, no further records were provided. The auditor specified that those records requested but not made available included sales tax worksheets, Federal income tax returns, general ledger, cash register tapes, sales journals, purchase journals, day books, purchase invoices and sales invoices.

Petitioner indicated that his cash register tapes are destroyed at the end of each day after petitioner enters certain totals, including gross sales and sales tax collected, in a receipts journal. Petitioner filed his sales tax returns by consistently estimating that 40% of gross sales were taxable sales.

Faced with the lack of records as described, the auditor concluded that petitioner's records were inadequate for purposes of performing an audit and determined to resort to external indices, including specifically an observation test, to calculate petitioner's sales and sales tax liability. Accordingly, on September 25, 1986,¹ the auditor (and one assistant) conducted an observation of petitioner's sales of prepared foods between the hours of 6:00 A.M. and 2:00 P.M. The results of this observation test included the following:

- (a) Gross sales for the observation, per cash register summary, totalled \$2,137.54. Taxable prepared food sales, as observed, totalled \$718.81. The difference between these two amounts

¹The auditor advised petitioner, on September 18, 1986, that the observation test would be performed on Thursday, September 25, 1986 between 6:00 A.M. and 2:00 P.M.

(\$1,418.73) represented "other sales" (taxable and nontaxable).

(b) The auditor calculated weekly gross sales of \$13,884.00 as follows:

observed taxable prepared food sales of \$718.81 x 5.5 days per week.....	\$ 3,953.00
plus	
other sales of \$1,418.73 x 7.0 days per week....	<u>9,931.00</u>
= Gross Sales.....	<u>\$13,884.00</u>

(c) The auditor calculated weekly and quarterly taxable sales as follows:

weekly taxable prepared food sales.....	\$ 3,953.00
plus	
other sales of \$1,418.73 per day x 31.18% ² taxable x 7 days per week.....	<u>3,097.00</u>
= weekly taxable sales.....	\$ 7,050.00
number of weeks per quarter.....	x 13
= quarterly taxable sales.....	<u>\$91,650.00</u>

(d) The auditor compared weekly taxable sales (\$7,050.00) to weekly gross sales (\$13,884.00), determining a taxable ratio of 51%. In turn, by extension, the auditor computed gross sales of \$4,021,003.00 and taxable sales of \$2,057,387.00 for the audit period. This latter figure resulted in sales tax liability of \$150,823.35 which, after credit for tax paid (\$47,299.95) leaves additional tax due of \$103,523.40.

Among other additional steps, the auditor divided petitioner's reported gross sales per returns for the quarterly period ended November 30, 1986, (\$71,855.00), by the 91 days in such three-month quarterly period, yielding an average daily gross sale amount of \$790.00. The auditor compared such resulting daily gross sale amount to the \$718.81 in taxable sales of prepared foods as determined during the 8-hour observation test, concluding that petitioner's returns were inaccurate and incorrect as filed. Accordingly, the auditor recommended assessment of the \$103,523.40 of tax found due on audit, plus penalty and interest, and the notices of determination described in Finding of Fact "1", supra, were issued.

Petitioner objected to the results of the observation test claiming the same to be

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The estimate that 31.18% of other sales represent taxable grocery sales is based on Division of Taxation experience. There is no evidence that petitioner challenges such estimate.

unrepresentative of his business, and requested that a second observation test be conducted. On January 15, 1987, Division of

Taxation auditors appeared at petitioner's premises, unannounced, to conduct a second observation test. However, telephone conversations between petitioner and his representative and the Division's auditors resulted in the auditors being asked to vacate the premises. The auditors moved to petitioner's parking lot, after which the local police (at petitioner's request) asked the auditors to leave. In turn, the auditors relocated across the street and counted the number of persons entering petitioner's premises. However, since the auditors were left with no means by which to verify purchases, if any, by the persons entering the premises, the results of such count were deemed essentially worthless and were not used in any of the calculations at issue.

Petitioner timely protested the assessments and a conciliation conference was held on this matter. As a result of such conciliation conference, certain recalculations were made and a conciliation order was issued on May 27, 1988, the effect of which was to reduce the amount of tax due to the aggregate total of \$59,369.35, plus penalty and interest, including the noted (recalculated) "omnibus" penalty. The basis for the conciliation conference reduction is set forth as follows:

- (a) 30% of total Lotto sales of \$2,427.50 for the week during which the observation was conducted was attributed to the observation day. Such resulting amount (\$728.28) was treated as nontaxable receipts hence reducing observation day gross sales from \$2,137.54 to \$1,409.29.
- (b) Taxable prepared food sales, as observed, (\$718.81) were multiplied by 5.0 days (as opposed to 5.5 days) yielding weekly taxable prepared food sales of \$3,594.05.
- (c) "Other sales" of \$690.48 (the difference between gross sales of \$1,409.29 [item "a" above] and observed prepared food sales of \$718.81) were further reduced by \$52.70 based on one substantiated exempt sale. The resulting amount of \$637.78 was multiplied by 31.18% (see Footnote "2") to arrive at taxable other sales of \$198.86 per day, which was then multiplied by 7 to arrive at weekly taxable other sales of \$1,392.02.
- (d) Weekly taxable prepared food sales (\$3,594.05) plus weekly taxable other sales (\$1,392.02) results in revised total weekly taxable sales of \$4,986.07 and quarterly

taxable sales of \$64,819.00.

(e) Comparing audited quarterly taxable sales (\$64,819.00) to quarterly reported taxable sales (\$28,742.00) results in a margin of error of 2.2552 and, by extension audited taxable sales of \$1,455,082.00 for the audit period. In turn, tax due thereon of \$106,658.00 was reduced by the amount of tax paid, to arrive at the recalculated amount of \$59,369.35 remaining at issue (exclusive of penalty and interest).

Petitioner continues to protest the reduced assessment at issue herein seeking certain additional items of allowance or reduction. More specifically, petitioner is located near the Suffolk County office buildings as well as several other business buildings and the day of observation (a Thursday) was a pay day for County workers and various other business workers, thereby leading petitioner to argue that the observation test day would show inordinately high sales and therefore would not be representative of the balance of petitioner's business.

Petitioner testified that a Thursday pay day represents approximately 40% of the total volume of sales for a given week. In addition, petitioner alleges that taxable prepared food sales of \$718.81 as actually observed should be disregarded in favor of taxable sales per cash register summaries on the observation day (\$398.93), and that the attribution of 30% of total weekly Lotto sales as observation day sales should be increased to 34%. Petitioner also points out that his cash register is cleared each day at 2:00 P.M. when petitioner takes cash to the bank for deposit. Thus petitioner alleges that the 6:00 A.M. to 2:00 P.M. observation test would reflect in the cash register totals of gross sales certain sales from the previous day. Finally, petitioner argues that tax exemption was improperly disallowed on a particular sale to St. John the Baptist Church, as described hereinafter. Petitioner argues that the proper margin of error, if petitioner's adjustments are accepted, should be 1.2310, as opposed to the Division's post-conference 2.2552 margin of error, and would result in a tax liability of only \$9,462.00.

Finally, petitioner argues that the Internal Revenue Service conducted an in-depth audit of his 1982 and 1983 Federal income tax returns which resulted in only \$570.00 of additional tax due.

Petitioner testified that, during the audit period, he retained his purchase invoices, a listing of his gross sales total for each day, a list of total Lotto sales for the day and his bank statements. He admitted that he destroyed cash register tapes at the end of each day, and that

certain purchases were made by cash payouts from the cash register. Petitioner submitted certain Lotto receipts records for various periods during and after the audit period in support of his argument that on average 34% of weekly Lotto sales should be deemed Thursday sales. Other resulting averages of Wednesday/Thursday Lotto sales compared to weekly Lotto sales included 37%, 45%, 30% and 26%. Particular records of Lotto sales for the day of observation were not submitted by petitioner.

Petitioner's business opens each day at 6:00 A.M. and remains open through 10:00 P.M. during the summer months and until 9:00 P.M. during the winter months. In extending its totals from the daily observation results to arrive at weekly taxable prepared food sales, the auditors utilized a factor of 5.5 days on audit and 5.0 days in connection with the conference reduction. By contrast, and in connection with his contention that 40% of total weekly sales occur on Thursdays, petitioner argues that such observation results should be multiplied by a factor of only 2.5 days.

With respect to the claimed disallowed exempt sale, petitioner provided a sales invoice indicating the delivery of 110 sandwiches to St. John's Over Fifty Club. This delivery ticket indicates a date of September 24, 1986 (the day before the observation), an amount of \$466.00, and a 1:00 P.M. delivery time. Petitioner personally delivered the sandwiches, returned to the deli at approximately 2:30 P.M. and allegedly entered the \$466.00 in the cash register. Petitioner argues that because the cash registers are cleared each day at 2:00 P.M., the \$466.00 would appear in the register totals on the following day (i.e. September 25, 1986) when the observation test was conducted. Therefore, petitioner argues that the allowance for exempt sales should be increased by the \$466.00 amount of such sale. In turn, petitioner also alleges the sale to be properly exempt as made to a club of St. John the Baptist Church.

Petitioner submitted an exemption certificate dated January 19, 1988 from the Roman Catholic Community of St. John the Baptist Church together with a letter from the church's pastor stating that "the Over Fifty Club of St. John's is part of St. John the Baptist Roman Catholic Church, and has been in existence since 1981." Petitioner also submitted a letter from

one Marion Boomer, president of the Over Fifty Club. This letter, dated September 19, 1989, provides as follows:

"Please be advised that our club 'Over Fifty Club of St. John the Baptist', Wading River received 110 dinners in the amount of \$466.00 on September 24, 1986. We are a tax-exempt organization of the church and use their tax number EX122611. These dinners were paid for in cash that day as monies were collected from the members."

The audit report in this matter indicates that petitioner had been previously audited for the period March 1, 1978 through May 31, 1981 and that an assessment was issued as a result thereof in the amount of \$38,330.97. The disposition of such assessment is not specified on the record.

SUMMARY OF THE PARTIES' POSITIONS

The Division asserts that its resort to external indices, including specifically an observation test, was warranted given the absence of adequate records from which to conduct a detailed audit of petitioner's tax liability. The Division further alleges that petitioner offered no evidence which would warrant reductions to the assessed amounts in addition to those afforded by the Division as a result of the conciliation conference described herein.

As to the adequacy of records, petitioner makes no specific allegation that the records maintained for sales tax purposes were adequate or complete. Petitioner only argues that inasmuch as a Federal income tax audit resulted in a negligible amount of tax due, it is reasonable to infer that petitioner's records and its operations were adequate and that all taxes, including sales taxes, were paid. Petitioner maintains further that Thursday is the busiest day of the week for the business and that rather than a 5.0 day factor for extension, a 2.5 day factor should be utilized. Petitioner also argues, as described, that 34%, as opposed to the 30% allowed at conference, is the proper average amount of nontaxable lottery receipts attributable to Thursday, and that the sale of 110 dinners to the St. John's Over Fifty Club should be allowed as an exempt sale.

CONCLUSIONS OF LAW

A. The Tax Law, attendant regulations, and abundant case law developed in connection

therewith leave it well settled that a vendor such as petitioner 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 of Taxation (see, Tax Law §§ 1138(a), 1135, 1142.5; see, e.g., Matter of Mira Delicatessen and Emil Mekhail, as Officer, 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] 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 Commission, 65 AD2d 44). "When records are not provided or are incomplete and insufficient, it is [the Commissioner's] duty to select a method reasonably calculated to reflect the taxes due.... The burden then rests upon the taxpayer to demonstrate...that the method of audit or the amount of the tax assessed was erroneous" (Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858).

B. In this case, despite repeated requests for records over an extended period of time, petitioner maintained and made available only limited books and records which, in their entirety, were not adequate for purposes of conducting an audit to determine the accuracy of petitioner's sales tax returns as filed. In particular, no guest checks or cash register tapes were available for the period in question. In fact petitioner himself admitted as much through his description of recordkeeping, specifically noting the destruction of cash register tapes at the end of each day. It therefore follows that the Division of Taxation was entitled to resort to indirect methods and estimates as a means of determining petitioner's sales and calculating his sales and use tax liability. Utilization of estimates in arriving at petitioner's liability is even more clearly justified when it is noted that petitioner's own filings were made utilizing an estimation method whereby 40% of petitioner's gross sales were treated as taxable on a quarterly basis. It is noted that petitioner's argument regarding records vis-a-vis a Federal income tax audit in no way

suffices to establish that petitioner maintained adequate records for sales tax purposes. The facts of this case completely refute any such assertion.

C. Petitioner's challenge to the subject assessments focuses essentially upon alleged errors in the method of calculation. More specifically, petitioner challenges whether the observation day was a day representative or typical of petitioner's business. Petitioner also challenges the estimated allowance for Lotto sales, one disallowed claimed exempt sale, and the fact that cash register totals at the end of the observation period included sales from a portion of the prior day.

D. Petitioner's arguments are insufficient to warrant further reductions to the assessments. In this vein, it is clear that indirect audit methodologies may not always result in an exact determination of liability. However, it is equally clear that where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to such indirect audit techniques, exactness is not required of the Division in arriving at its determination and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Brothers, Inc. v. Chu, 139 AD2d 813). With respect to Lotto sales, petitioner's estimate thereof has not been shown to be more reasonable than the estimate used by the Division in affording reduction at conference. In the same vein, and absent records, there is no reason to accept petitioner's factor of 2.5 days in favor of the Division's factor of 5.0 days.

With respect to the claimed exempt sale, in the absence of cash register tapes there is no proof that the \$466.00 receipt was included in the register and was included after 2:00 P.M. on the day prior to the observation (and thus would be included in the gross sales total for the day of the observation). In addition, it must be pointed out that the sale was not made to St. Johns, but rather represented the sale of meals to individual members of a club (the Over Fifty Club). There being no evidence that such club has been granted exempt organization status in its own right, the Division properly disallowed petitioner's claim of exemption on the sale in question. Finally, the fact that the register clearing times would leave gross sales in the register total from

a portion of the prior day, and thus include such amounts during the audit, appears to inure to petitioner's benefit. More specifically, the observation tallied taxable prepared food sales from the time period of 6:00 A.M. through 2:00 P.M. Presumably, had the observation included the period for which receipts from the prior day were in the register (i.e. 2:00 P.M. September 24 through closing on September 24), additional taxable prepared food sales would have occurred thereby increasing the percentage of taxable prepared food sales compared to gross sales, thus increasing petitioner's overall taxable ratio.

E. With regard to the penalties imposed, petitioner has offered no specific argument for the abatement thereof. In fact, petitioner admits in his petition to a margin of error and a resulting underpayment, albeit a lesser margin than that determined by the Division of Taxation. Moreover, there is evidence that petitioner was consistently late in filing sales tax returns (see Finding of Fact "1"), and also had been previously audited for sales tax purposes with a substantial underpayment determined. These factors together tend to support imposition of penalty. In turn, in order for penalties to be abated, the burden is on petitioner to establish reasonable cause as well as an absence of willful neglect (see, Matter of Baird v. State Tax Commn., 102 AD2d 958; Matter of Miller v. State Tax Commn., 94 AD2d 841). Petitioner has failed to meet this burden. In addition to offering no specific argument against penalties, petitioner chose to compute his liability and file returns based on estimates, thereby running the risk that upon audit a substantial underpayment would be computed. This is exactly what occurred and penalties therefore are sustained.

F. The petition of Robert Trustnovac d/b/a Yaphank Community Shop is hereby denied and the notices of determination and demands for payment of sales and use taxes due dated June 1, 1987, as reduced however in accordance with the results of the conciliation conference, together with penalty and interest are sustained.

DATED: Troy, New York
