STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition of JOHN ROSEMELLIA D/B/A THE BURT 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, 1984 through November 30, 1987.	:	DETERMINATION
In the Matter of the Petition of JOHN A. AND NANCY F. ROSEMELLIA for Redetermination of Deficiencies or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Years 1985 through 1987.	:	

Petitioner John Rosemellia d/b/a The Burt Restaurant, 2083 Lockport- Olcott Road, Burt, New York 14028, 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, 1984 through November 30, 1987 (File No. 807113).

Petitioners John A. and Nancy F. Rosemellia, 2083 Lockport-Olcott Road, Burt, New York 14028, filed a petition for redetermination of deficiencies or for refund of personal income tax under Article 22 of the Tax Law for the years 1985 through 1987 (File No. 807705).

A consolidated hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 462 Washington Street, Buffalo, New York, on September 14, 1990 at 9:00 A.M., with all briefs to be submitted by January 9, 1991. Petitioners appeared byChristopher L. Doyle, Esq., and Saul Glazer, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUES

I. Whether petitioner consented to the fixing of sales tax, penalty and interest as determined pursuant to a sales tax audit and thereby irrevocably fixed such tax, penalty and interest pursuant to Tax Law § 1138(c).

II. If not, whether the Division of Taxation properly determined petitioner's sales tax liability.

III. Whether the Division's denial of petitioner's refund claim made in respect of certain penalties assessed and paid pursuant to a Statement of Proposed Audit Adjustment was proper.

IV. Whether the Division properly determined additional income tax due by using the results of the prior sales tax audit.

V. Whether petitioner has demonstrated reasonable cause to justify abatement of penalties asserted in respect of the income tax deficiencies.

FINDINGS OF FACT

Petitioner John A. Rosemellia owns and operates The Burt Restaurant, a small, neighborhood-type bar located in Burt, New York.

Petitioner filed joint New York State personal income tax returns with his wife, petitioner Nancy F. Rosemellia, for the years 1985 through 1987. Nancy F. Rosemellia is a petitioner herein solely by reason of her having filed such joint returns. Accordingly, unless otherwise indicated, all references to "petitioner" herein shall refer to John A. Rosemellia.

On January 6, 1988, the Division of Taxation commenced a sales tax audit at petitioner's premises. At that time, the Division reviewed petitioner's sales and income tax returns, purchase and sales journals, and purchase invoices. Petitioner did not maintain cash register tapes. Indeed, although petitioner had a cash register, he used it only to store money and to get change; he did not use it to record any individual sales.

Petitioner's Federal schedule C's filed in respect of the years 1984 through 1986 indicated gross receipts, cost of goods sold, gross profit and markup percentage[1] amounts as

[1]The schedule C's did not list a markup percentage. The percentage set forth herein constitutes the ratio of gross profit to cost of goods sold figures as set forth on the schedule C's.

follows:

	1984	1985[2]	1986
Gross Receipts	$37,527.00	$33,999.00	$35,302.00
Cost of Goods Sold	30,619.00	30,421.00	35,111.00
Gross Profit	6,908.00	3,578.00	191.00
Markup Percentage	22.6%	11.8%	.5%

Given petitioner's failure to maintain records of any individual sales and what the Division considered to be a low markup percentage (as reflected in petitioner's Federal returns), the Division endeavored to conduct a markup audit of petitioner's purchases. The Division used petitioner's 1986 purchases as indicated by his records to determine petitioner's markups on liquor, beer and food (snacks). First, the Division separated petitioner's 1986 purchases into three categories and determined additional taxable sales as follows:

(a) With respect to beer, petitioner sold 12-ounce bottles, 7-ounce bottles (splits) and 6-packs (12-ounce bottles). The Division first totaled the number of cases of beer purchased by petitioner in 1986. From this total the Division subtracted the number of cases of beer sold in 6-packs by petitioner during this year. Petitioner advised the Division that 199 cases were attributable to 6-pack sales. At four 6-packs per case, petitioner thus sold 796 6-packs in 1986. Based on discussions with petitioner, the Division determined a selling price of $5.00 per 6-pack, or $3,980.00 in receipts for 6-pack sales. The Division then took the difference between total cases purchased and cases attributable to 6-pack sales, determined the total number of bottles at 24 bottles per case, made a 15% allowance for spillage and giveaways, and, using $1.00 per bottle as a selling price, determined $47,736.00 in total receipts from sales of 12-ounce bottles of beer during 1986. The $1.00 per bottle selling price was determined by the Division pursuant to discussions with

[2]Petitioner's 1985 schedule C actually listed gross receipts and cost of goods sold amounts that were erroneously doubled. Gross receipts and cost of goods sold were listed on the return as $67,998.00 and $60,842.00, respectively. This error flagged petitioner for audit.

petitioner. The Division then determined petitioner's sales of splits in the same manner, i.e., total number of bottles purchased, less 15% spillage and giveaway allowance, multiplied by a 50 cents per bottle selling price, which resulted in 1986 receipts from splits of $1,295.00. The selling price for splits was also determined pursuant to discussions with petitioner.

(b) Next, the Division totaled beer sales from each of the three categories and divided that total by 1.07 to allow for the inclusion of sales tax in the selling price to reach taxable sales of beer for 1986 of $49,543.00. Petitioner's 1986 beer purchases totaled $24,230.00. The Division thus determined petitioner's markup on beer to be 105%.

(c) For liquor, the Division totaled petitioner's purchases for 1986 and listed the size of each bottle purchased. On audit, petitioner advised the Division that he used a one-ounce shot of liquor in his drinks and that the selling price for drinks was $1.00. Using this information, the Division determined the total number of drinks sold based on the liquor purchases. As with the beer sales, the Division made a 15% spillage allowance in this determination. The Division calculated total receipts from liquor sales during 1986 of $24,548.00. This total was divided by 1.07 to allow for inclusion of sales tax in the purchase price. The resulting additional taxable liquor sales totaled $22,942.00. Petitioner purchased $6,407.00 worth of liquor in 1986. Petitioner's markup on liquor was thus 258%.

(d) For food (or snacks), the Division determined that, during 1986, petitioner paid 22 cents for a bag of chips and sold it for 40 cents including tax. This resulted in a 68% markup on food. Petitioner did not dispute this component of the audit.

(e) The Division next applied the markups on beer, liquor and food as determined above to petitioner's purchases per his records throughout the audit period. This resulted in a determination of additional taxable sales during the audit period of $112,631.00 and additional tax due of $7,884.17.

The sales tax audit was conducted at petitioner's

premises. The auditor was at the premises for at least part of five days during January 1988. The final day that the auditor was on petitioner's premises was January 27, 1988. At that time, the auditor reviewed the results of the audit with petitioner. The auditor advised petitioner that his supervisor was unconvinced that petitioner's selling price for drinks during the audit period was $1.00, but that the Division would accept the $1.00 selling price if petitioner would accept the results of the audit. Petitioner advised the auditor that he would think it over. The Division subsequently sent petitioner a Statement of Proposed Audit Adjustment (Form AU-3), dated January 29, 1988, which set forth the tax determined due on audit of $7,884.17, plus penalty and interest, for the period December 1, 1984 through November 30, 1987. The penalty set forth on the AU-3 included penalty pursuant to Tax Law § 1145(a)(1)(i) and (vi). Petitioner signed the AU-3 which, by the terms of said form, indicated agreement with the proposed assessment of tax, penalty and interest and also indicated that petitioner consented to the fixing of tax, penalty and interest as set forth thereon. Petitioner dated his signature February 10, 1988 and mailed the form back to the Division. The form was stamped received by the Division's Buffalo District Office on February 16, 1988.

On May 11, 1988, the Division issued to petitioner a Notice and Demand for Payment of Sales and Use Taxes Due which demanded payment of the tax consented to by petitioner by his signature on the AU-3, plus Tax Law § 1145(a)(1)(i) penalty and interest.

Also on May 11, 1988, the Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due which assessed $693.77 in Tax Law § 1145(a)(1)(vi) penalty set forth on the AU-3.

On January 10, 1989, petitioner filed an Application for Credit or Refund of State and Local Sales or Use Tax (Form AU-11) claiming a refund of $693.77 in "penalty paid on sales tax assessments".

By letter dated May 2, 1989, the Division denied petitioner's refund claim in full.

Following the issuance of the notice and demand and notice of determination, the Division commenced an income tax audit of petitioner for the years 1985 through 1987. On this audit, the Division reviewed the sales tax audit workpapers. Next, the Division conducted a bank deposits analysis and cursory source and application of funds analysis of petitioner's records with respect to the years in question.[3] The Division used these two income reconstruction methods to verify the existence of additional receipts as indicated by the sales tax audit results. These methods revealed additional income attributable to petitioner as follows:

Method	1985	1986	1987	
Source and Application		$ 3,307.00	$ 8,431.00	$17,749.00
Bank Deposits		10,629.00	10,631.00	24,227.00

Given the existence of the signed consent to the results of the sales tax audit, the Division redetermined petitioner's personal income tax liability based solely on the results of that audit. On November 21, 1988, the Division issued to petitioner two statements of personal income tax audit changes that indicated increases in petitioner's income, based on the sales tax audit, as follows:

	1985	1986	1987	
Increase in income		$34,215.00	$44,631.00	$29,639.00

On February 10, 1989, the Division issued to petitioner two notices of deficiency which asserted additional personal income tax due totaling $9,737.86, plus penalty and interest, for the years 1985 through 1987. The tax asserted in the notices was premised on the additional audited income set forth in the statements of personal income tax audit changes.

Petitioner entered into evidence certain computations prepared by his accountant. Such

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[3]In the auditor's opinion, the bank deposits analysis was sufficiently completed such that a Notice of Deficiency could have been issued based upon this method. The source and application analysis was incomplete and would have required further information before a Notice of Deficiency could have been issued.

computations purported to recalculate petitioner's gross receipts during the audit period using the same basic methodology as that used by the sales tax auditor, except that petitioner's accountant used 85 cents as the average selling price of beer, 75 cents as the average selling price of mixed drinks, and $3.85 for 6-packs. The accountant also used a larger amount of alcohol per mixed drink. (The auditor used one ounce of liquor per drink with a 15% spillage allowance resulting in 28.7 drinks per liter. The accountant used a figure of 20 drinks per liter.) The accountant also made adjustments for ladies' night and happy hour by a determination that 56 drinks were given away at a weekly ladies' night during 1985 and 1986 and that 86 drinks per day were given away during a Monday through Friday happy hour in 1985 and 1986. The accountant thus determined that petitioner lost a total of $27,841.00 in sales as a result of such giveaways during 1985 and 1986. The accountant's calculations indicated total sales of $134,713.00 for the three years at issue, a difference of $28,174.00 from sales reported on petitioner's sales tax returns for the same period.

CONCLUSIONS OF LAW

The Sales Tax Assessment

A. Tax Law § 1138(c) provides as follows:

> "A person liable for collection or payment of tax (whether or not a determination assessing a tax pursuant to subdivision (a) of this section has been issued) shall be entitled to have a tax due finally and irrevocably fixed prior to the ninety-day period referred to in subdivision (a) of this section, by filing with the tax commission a signed statement in writing, in such form as the tax commission shall prescribe, consenting thereto."

B. The record in this matter clearly establishes that petitioner signed the consent portion of the Statement of Proposed Audit Adjustment (Form AU-3). It is noted that this form is specifically referenced in the Division's regulations as a "Consent to Fixing of Tax Not Previously Determined or Assessed" (20 NYCRR 535.6). By his signature on the consent form, petitioner manifested his unqualified intention to take full advantage of the provisions of Tax Law § 1138(c) and thereby have the tax finally and irrevocably fixed. It is concluded, therefore, that by his signature on the consent form petitioner was bound pursuant to Tax Law § 1138(c) to the results of the sales tax audit and the tax, penalty and interest set forth on the consent.

Moreover, having consented to the tax, penalty and interest pursuant to Tax Law § 1138(c), the assessment was not subject to challenge through the administrative hearing process.

C. Petitioner asserted, for the first time during cross-examination by the Division's representative, that his signature did not appear on the consent form introduced into the record. Petitioner concedes that he signed a consent but that he signed it in the presence of the auditor and that the consent introduced into the record was not signed by him. On brief, petitioner contends that "a simple comparison" of the signature on the consent and petitioner's signature on the Power of Attorney appointing his representative reveals that the signature on the consent is not his.

This contention is rejected. As to whether the signatures on the consent and the Power of Attorney were made by the same individual, my review of both such signatures along with other of petitioner's purported signatures in the record, including the signatures on petitioner's income tax returns, is inconclusive. As I am not a handwriting expert, such an inconclusive result is not unexpected. Petitioner presented no expert testimony to substantiate his claim. Nor did petitioner present the testimony of any other individuals to corroborate his claim. In addition, it should be noted that the consent form bears a typed date of January 29, 1988, a date next to petitioner's signature of February 10, 1988, and a stamp indicating receipt by the Division's Buffalo District office on February 16, 1988. This series of dates clearly corroborates the Division's version of the facts regarding the signing of the consent, e.g., that the auditor mailed the consent form to petitioner following the audit, and that petitioner signed the consent and mailed it back to the Division. This objective proof also contradicts petitioner's version of the events surrounding his signing of a consent, e.g., that he signed a consent in the auditor's presence on the auditor's first visit to the premises. In sum, the objective proof contradicts petitioner's testimony and no expert evidence, indeed no corroborative evidence of any kind, has been offered to support petitioner's testimony. Under the circumstances, petitioner's testimony is not persuasive and this contention is rejected accordingly.

D. Petitioner next contended that his signing of the consent was coerced. This

contention is also rejected. The facts as found herein indicate that the auditor advised petitioner that, while the Division was unconvinced of the $1.00 drink price, it would accept that price if petitioner signed the consent form. This course of conduct by the Division was not in any way improper. Inasmuch as it would have been permissible for the Division to reopen the audit at the time of the auditor's final discussions with petitioner,[4] it was certainly

permissible for the Division to apprise petitioner of this possibility as a means of negotiation or settlement during discussions with petitioner. There is no question in this matter that petitioner understood that by his signature he was consenting to the fixing of tax. There is also no allegation that the Division misled or deceived petitioner in any way. (It is noted that petitioner did not allege that the Division coerced his consent to the sales tax audit by the fact that it did not advise him that the results of the sales tax audit might have income tax consequences.) Moreover, the facts indicate that the consent form was mailed to petitioner and was signed outside the presence of the auditor. In sum, petitioner alleges that the Division coerced his consent merely by advising him that it might take action that it was permitted by law to take. This is clearly not a situation where an executed consent should be nullified.

E. Petitioner also applied for a refund in respect of the omnibus penalty included as part of the statement of audit adjustment. Penalty may be abated where petitioner shows reasonable cause and an absence of willful neglect (Tax Law § 1145[a][1][iii]). Given petitioner's inadequate recordkeeping, it cannot be said that petitioner's failure was reasonable. Petitioner's refund claim is therefore denied. Inasmuch as petitioner's failure to accurately report his taxable sales (indeed, petitioner apparently concedes an underreporting of about $28,000.00 [see Finding of Fact "14"]) seems to result from a failure to maintain any records of specific sales, such failure appears to result from petitioner's own neglect and not any reasonable cause. The

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[4]Indeed, the Division may refuse its consent to an executed Statement of Audit Adjustment within 60 days after the signed statement is received and may issue a notice of determination asserting a greater liability than that set forth in the statement (see, Matter of Adirondack Steel Casting Co. v. New York State Tax Commn., 121 AD2d 834, 504 NYS2d 265).

Division's denial of petitioner's refund claim was therefore proper.

The Income Tax Deficiencies

F. Where there is some factual basis for deciding that tax returns, as filed, do not accurately reflect the true income received by a taxpayer, the Division of Taxation may determine proper income by using an indirect audit method (see, Tax Law § 681[a]; Holland v. United States, 348 US 121, 131-132; Hennekens v. State Tax Commn., 114 AD2d 599). It is well established that the results of an audit conducted under one article may properly be used in an audit conducted under another article of the Tax Law (see, Matter of Joseph and Dolores Bonanno, Tax Appeals Tribunal, December 13, 1990; Matter of Attilio Castaldo, State Tax Commn., February 15, 1985).

G. Here, the Division's sales tax audit revealed an underreporting of taxable sales. A comparison of the sales tax audit results with petitioner's reported taxable income thus indicated an underreporting of taxable income. The Division's use of the sales tax audit results as the basis for issuing the notices of deficiency to petitioner was therefore proper.

H. Where, as here, the Division properly issues notices of deficiency to a taxpayer, a presumption of correctness attaches to such notices (Matter of Tavolacci v. State Tax Commn., 77 AD2d 759, 431 NYS2d 174, 175; Matter of Charles W. Denn, Tax Appeals Tribunal, October 25, 1990). Petitioner bears the burden of proof to overcome this presumption (Tax Law § 689[e]).

I. Petitioner has failed to establish any errors in the Division's audit methodology. Consequently, there is no basis upon which to make any adjustments in the asserted income tax deficiencies. Petitioner presented no documentation to support his contentions and it is the absence of any such documentation that results in petitioner's failure to meet his burden herein.

With respect to the question of petitioner's selling prices for beer and mixed drinks, petitioner sought to establish that his actual selling prices for beer and mixed drinks were less than the $1.00 price used on audit, and presented the testimony of two patrons, an employee and himself to establish this contention. All four witnesses testified that the price of both a beer and

mixed drink was 75 cents in 1986. No testimony was offered as to the price of a drink or beer during 1985 or 1987, although the employee speculated that the price might have gone up to 80 or 85 cents in 1987. The testimony of the four witnesses on this point was unconvincing and, in the absence of any corroborating records or other documentation, this contention must be rejected. Petitioner also sought to establish that the amount of liquor in his mixed drinks sold during the audit period was greater than one ounce. To that end, petitioner sought to demonstrate the amount of liquor he used in mixed drinks during the audit period. This self-serving demonstration was unpersuasive and was also uncorroborated by any documentation. This contention must also be rejected. Finally, petitioner sought to establish through testimony the effect of specials (i.e., ladies' night and happy hour) on his receipts. Petitioner presented testimony as to the number of persons in the bar during such promotions and the average number of drinks consumed per person. This testimony is sheer speculation and is also rejected.

J. Petitioner noted the additional income shown by both the income tax auditor's source and application of funds analysis (see Finding of Fact "11") and his accountant's computations (see Finding of Fact "14") and contended that the relative similarity in the results of each tended to validate the factual basis upon which the accountant's computations were premised. This contention is rejected. First, the source and application method employed herein was incomplete (see Finding of Fact "11", footnote "3"). It is unclear how the results from such an incomplete analysis could persuasively validate much of anything. Second, as noted above, petitioner failed to establish the factual contentions upon which his accountant's computations were based.

K. In regard to the issue of penalty, there has been no showing that petitioner's underreporting of income resulted from anything other than his own failure to maintain accurate records of his sales. It is noted that petitioner apparently concedes that he failed to report about $28,000.00 in income during the audit period. This failure appears to result from petitioner's neglect and not from any reasonable cause (see, 20 NYCRR 102.7). Penalties in respect of the income tax deficiencies are therefore sustained.

L. The portion of the petition of John Rosemellia d/b/a The Burt Restaurant filed in protest of the notice and demand dated May 11, 1988 is dismissed as the tax set forth in said notice was finally and irrevocably fixed pursuant to Tax Law § 1138(c) and not subject to challenge through the administrative hearing process.

M. The portion of the petition of John Rosemellia d/b/a The Burt Restaurant filed in protest of the Division's denial of petitioner's refund claim is denied.

N. The petition of John A. and Nancy F. Rosemellia is denied and the notices of deficiency, dated February 10, 1989, are sustained.

DATED: Troy, New York
6/20/91

ADMINISTRATIVE LAW JUDGE