

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
JUERGEN STAEKELER AND	:	DETERMINATION
EDELWEISS INTERNATIONAL, LTD.	:	DTA NOS. 819435
	:	AND 819436
for Revision of Determinations or for Refund of Sales and		
Use Taxes under Articles 28 and 29 of the Tax Law for the :		
Period September 1, 1997 through May 31, 2000.		

Petitioners, Juergen Staekeler, 2897 Wading River Road, Wading River, New York 11792 and Edelweiss International, Ltd., 833 Old Country Road, Riverhead, New York 11901, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1997 through May 31, 2000.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York on December 10, 2003 at 11:30 A.M., with all briefs to be submitted by June 21, 2004 which date began the six-month period for the issuance of this determination. Petitioners appeared by Jay Oher, C.P.A., P.C. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Cynthia E. McDonough, Esq., of counsel).

ISSUE

Whether the audit methodology employed by the Division of Taxation was reasonably calculated to reflect the sales and use taxes due.

FINDINGS OF FACT

1. Petitioner Edelweiss International Ltd., doing business as Heros Plus (“Heros”), was a delicatessen and sandwich shop located on a busy thoroughfare near a traffic circle in Riverhead, New York. A regional hospital was located diagonally across the street. Petitioner Juergen Staekeler was the sole shareholder of the business. Heros sold prepared food as well as unprepared food such as cold cuts by the pound, potato salad and macaroni salad. It also sold German novelty items. It did not have any inside seating and did not sell beer or cigarettes.

2. On June 7, 2000, the Division of Taxation (“Division”) sent a letter to Heros requesting an audit appointment. The letter asked that Heros have all of its books and records pertaining to its sales and use tax liability for the period under audit, September 1, 1997 through May 31, 2000, available on the appointment date including “financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, federal income tax returns, and exemption certificates.” The letter further explained that “[e]xemption certificates not made available at this appointment may be disallowed. If an exemption certificate is disallowed, you will be held liable for any tax due on the related transactions.” In response, the Division saw a general ledger, a day book, copies of Federal returns, purchase invoices, sales tax worksheets, sales tax returns and monthly balance sheets. The Division was not presented with any cash register tapes or any reconciliations between the daily sales and the bank deposits.

3. The absence of cash register tapes was regarded as a serious problem because without cash register tapes the Division could not verify the accuracy of the amounts recorded in the day book, the Federal returns or the general ledger. A second problem was presented because of the nature of the business. That is, food sales may be either taxable or nontaxable. For example, prepared food is taxable while unprepared food, such as cold cuts sold by the pound, is not

taxable. Here, although certain records were made available, there were no books or records which showed whether Heros' sales were taxable or nontaxable. The Division was also unable to account for cash deposits because of the failure to present cash register tapes or reconciliations between daily sales and bank deposits. On the basis of the forgoing, the Division concluded that the books and records were inadequate to determine taxable sales and that an observation test was necessary.

4. An observation test was conducted on Thursday, October 24, 2000. A Thursday was selected as the day to conduct the observation test on the basis of the auditor's opinion that Thursday was a representative day for sales. This judgement was premised upon having previously conducted 50 to 100 audits of delicatessens and an examination of the business's daybook of recorded sales for the months of September and October during the audit period. Further, the auditor was informed by petitioners' accountant that the amount of the business's sales did not fluctuate over the course of a year.¹

5. One investigative aide conducted the observation test from 7:00 A.M. until noon and a second investigative aide resumed the test until the store closed at 5:00 P.M. During the observation test, the investigative aides listed each item that was sold, how much the item was sold for and whether the item was taxable. The investigative aides found that on the day of the observation, Heros had gross receipts of \$2,095.00 and taxable sales of \$1,577.57.

6. The highest temperature on the day of the observation test was about 60 degrees and it was drizzling intermittently in the morning. The drizzling stopped later in the day.²

¹ An adjustment for sales fluctuations over the course of a year was referred to as seasonality.

² The investigator who conducted the morning shift of the observation test described the weather as 60 degrees with intermittent drizzle. The afternoon investigator said that it was drizzling slightly but that the drizzle stopped a short while later and that there was no additional precipitation during the observation.

7. The investigators noted that six individuals worked at the store. The first employee at the delicatessen began working at 6:30 A.M. Four employees worked until 5:00 P.M. Mrs. Staekeler was at the delicatessen from 9:15 A.M. until 1:00 P.M.

8. The delicatessen was located adjacent to Le's Nails and both stores were situated between a Getty gasoline station and a shopping center. There were 12 parking spaces for both stores. One employee of the store explained to an investigator that the business slowed down considerably when the nail salon opened because, once the nail salon opened, the delicatessen's customers had difficulty finding a parking spot. The investigators noted that when they changed shifts at noon, there were no empty parking spaces available for customers. They also noted that Heros was busy during the lunch period, but by 3:30 P.M., the amount of business activity had diminished. Mrs. Staekeler pointed out that Heros used to be open later in the day but then started closing earlier.

9. Heros had two cash registers, one was made by Samsung and one was made by Sharp. At the start of the observation, the investigator zeroed out the cash registers. The investigators noted that the tape on the Sharp register did not work and the Samsung register did not have a working tape until 11:40 A.M. when an employee replaced the paper. A catering order was not rung up at all and other items were improperly rung up.

10. In order to calculate the amount of tax due, the Division multiplied the amount of the daily taxable sales, according to the observation, by the 848 days that the business was open during the audit period according to petitioners' day book, which resulted in audited taxable sales of \$1,337,779.00.

11. The Division also analyzed petitioners' sales of German novelty items. The auditor noted that no German novelty items were sold during the observation test, and when examining

the German novelty items, she did not see any sales receipts or a price list. In addition, the auditor was not presented with any resale certificates or any indication that these items were resold to a wholesaler. Mr. Staekeler gave his invoices and resale certificates for the purchase of the German novelty items to his accountant who did not make the invoices and resale certificates accessible to the auditor. Relying upon a Robert Morris Associates survey of retail gift or souvenir shops that sold the same type of item, the Division applied a markup of 100 percent. The amount of purchases was obtained from wire transfers and some purchase invoices.

12. The Division calculated audited taxable sales by adding the sales determined by the observation test to the estimated sales of the German novelty items. Thereafter, the Division subtracted petitioners' reported taxable sales from the audited taxable sales to determine additional taxable sales. The amount of the additional taxable sales was divided by the reported taxable sales to calculate an error rate of 1.5551. Lastly, the amount of additional sales tax due was determined by multiplying the sales tax rate by the product of the error rate and the reported taxable sales.

13. Capital purchases were analyzed in detail. As a result, additional tax of \$1,600.16 was determined to be due on Heros' purchase of equipment.

14. On the basis of the forgoing audit, the Division issued a Notice of Determination (assessment number L-019696856), dated July 16, 2001, to Edelweiss International Ltd. which assessed sales and use taxes for the period September 1, 1997 through May 31, 2000 in the amount of \$73,342.18 plus interest of \$23,505.18 and penalties in the amount of \$28,413.01 for a balance due of \$125,260.37. The Division also issued a Notice of Determination (assessment number L-019809363) to Juergen Staekeler, dated July 19, 2001, which assessed sales and use taxes for the period June 1, 1998 through May 31, 2000, in the amount of \$54,167.61 plus

interest in the amount of \$14,866.52 and penalties in the amount of \$20,743.18 for a balance due of \$89,777.31. In each instance, the penalties were imposed for negligence and underpayment of tax including the omnibus penalty.

15. According to a statistical analysis of the auditor's transcription of the delicatessen's daybook for September and October, Thursdays were the second busiest day of the week. The analysis of the auditor's transcription shows that sales on Thursdays were approximately 12.6 percent higher than the average of all of the data. It also showed that there was a great deal of variability in the daily amount of sales.

16. In August 1997, a nail salon opened next door to Heros which had the effect of reducing the parking which was available for Heros' customers. The lack of parking caused sales to diminish. This was one of the reasons why Mr. Staekeler decided to open another store.

17. In 1999, Mr. and Mrs. Staekeler began operating a new business known as Wildwood Deli. During this period, Mr. Staekeler placed a manager in charge of Heros. Mr. Staekeler believes that the sales of Heros suffered from the absentee management. Eventually, Mr. Stakeler returned to Heros because he wanted to reverse the decline.

18. It was the practice of Heros' accountant to report a fixed percentage of the delicatessen's total sales as taxable. Heros' sales and use tax returns did not reflect any seasonal fluctuations.

19. A comparison of Heros' menu, at different times, shows that the prices of the food offered by the delicatessen increased over time. The audit workpapers show that at one juncture, the Division was prepared to include inflation as a factor in computing the amount of tax due based upon the consumer price index of the United States Department of Labor, Bureau of Labor Statistics. For an unknown reason, this was not done.

SUMMARY OF THE PARTIES' POSITIONS

20. At the hearing, Mr. Staekeler did not deny that he was a responsible officer of the corporation. Further, petitioners did not challenge the use of external indices. However, they disputed the accuracy of the audit methodology.

21. The Division maintains that the use of an indirect audit method was proper and that petitioner did not establish by clear and convincing evidence that the tax assessed was erroneous or that the audit method was unreasonable.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every “retail sale” of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A “retail sale” is “a sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . .” (Tax Law § 1101[b][4][i]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, “or if a return when filed was incorrect or insufficient, the amount of tax due shall be determined [by the Division 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][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see, Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.* (Tax Appeals Tribunal, February 20, 2003), as follows:

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, [102 AD2d 352, 477 NYS2d 858] *supra*) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), "from which the exact amount of tax due can be determined" (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (*Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

C. Petitioners' challenge to the assessments focuses upon specific aspects of the Division's audit methodology. Several of petitioners' objections, premised upon an analysis of Heros' day book, are as follows:

(1) Initially, petitioners argue that it was unreasonable to utilize a Thursday to conduct the observation test because an examination of the auditor's transcription of Hero's day book for the months of September and October, during the audit period, purportedly shows that sales on Thursdays are 12.6 percent higher than an average of all of the data.

(2) Petitioners next argue that the audit results are skewed because the months of September and October are allegedly busier than an average month. Petitioners maintain that Heros was busier in the winter than in the summer because most of the purchases were made by "white collar" office workers, and when their children were not attending school, business decreased. According to petitioners, the auditor knew that the months of September and October were busier months from an examination of the daybook. Further, Mr. Staekeler allegedly tried to discuss business trends with the auditor but she was not interested in listening. Petitioners contend that an analysis of the daybook shows that this adjustment, referred to as seasonality, warrants a reduction in the assessment by 6.49 percent.

(3) Petitioners submit that there should be an adjustment of 1.5 percent because Heros had fewer sales on those days when there was inclement weather. Petitioners reached this conclusion through an analysis of the daybook on those days when there was snowing or raining.

(4) Petitioners maintain that the assessments should be reduced by 9 percent to reflect the period of time that the delicatessen's sales declined while Mr. Staekeler was pursuing another business venture. In support of this argument, petitioners presented an analysis, based upon the daybook, denominated "Business Sales Trend," purporting to show a reduction in sales during 1999.

D. When the use of external indices is warranted and the audit method employed is facially sound, the taxpayer is required to establish by clear and convincing evidence that the

audit method employed and the amount of the assessment were erroneous (*see, Matter of Sol Wahba, Inc. v. State Tax Commn.*, 127 AD2d 943, 512 NYS2d 542). The arguments premised upon petitioners' daybook do not meet this burden. The difficulty is that there is no reason to believe that the data in the daybook is sufficiently accurate to establish that the observation test reached an erroneous result. The conduct of Heros' employees during the observation test supports this conclusion. During the observation test, the cash register tape on one machine was not working and a tape on the second machine was not inserted until about 11:00 A.M. A catering order was not rung up and other items were improperly rung up. It is concluded that even if the audit method was less than precise, the imprecision resulted from the inadequacy of petitioners' records, a problem which petitioners made (*Matter of Sol Wahba, Inc. v. State Tax Commn., supra*). Petitioners have not presented clear and convincing evidence that an analysis based upon the daybook is any more accurate than the procedure followed by the Division.

E. Petitioners contend that the auditor knew that the months of September and October were busier months from an examination of the daybook. The evidence does not support this argument. First, there is no evidence that the auditor examined the other months in the daybook in any detail. Further, since there was no documentary backup for the daybook there would be no reason to do so. Second, the auditor asked petitioners' accountant if there were any seasonal fluctuations and was told there was none. Clearly, if there were seasonal fluctuations, this would have been called to the attention of petitioners' accountant because it would have resulted in lower payments of sales tax in certain quarterly periods. Lastly, the sales tax returns, which

were purportedly based on a percentage of sales in the day book, do not reflect any seasonal fluctuations.³

F. The record establishes that the observation test was conducted in October because the audit was started in June and that by the time the Division reviewed the books and records and determined that they were inadequate, it was that time of the year. Further, the auditor chose a Thursday based on her experience that Thursdays were a representative day of the week for this type of business. It is well established that an auditor's experience is a rational basis for estimating taxable sales (*see, Matter of Oak Beach Inn Corp. v. Wexler*, 158 AD2d 785, 551 NYS2d 375; *Matter of Hanratty's/732 Amsterdam Tavern v. New York State Tax Commn.*, 88 AD2d 1028, 451 NYS2d 900, *appeal dismissed* 57 NY2d 954, 457 NYS2d 1028).

G. Petitioners contend that an adjustment is warranted because the audit does not take into account those days where sales were reduced because of inclement weather. This argument is flawed because it fails to consider the fact that there was inclement weather on the day that the observation test was conducted. Therefore, petitioners have already received the benefit of this adjustment for every day that the store was open during the audit period regardless of the weather conditions. Petitioners have not shown that they are entitled to an additional adjustment for inclement weather.⁴

³ Petitioners argue that the Division has taken an inconsistent position. Petitioners submit that having concluded that the sales and use tax returns were inaccurate, the Division cannot rely on the same sales and use tax returns to show that there was no seasonality. This argument is a non sequitur because it overlooks the fact that petitioners' accountant computed taxable sales on the basis of a percentage of the gross sales figures presented to him. Presumably these are the same amounts in the day book. It follows that petitioners cannot now claim that the daybook supports the conclusion that there were seasonal fluctuations when the sales tax returns do not.

⁴ Similarly, if sales were reduced by having less parking available for customers, this factor was also reflected in the observation test which was conducted.

H. Petitioners submit that the assessments should be reduced by 9 percent to reflect the period of time that the delicatessen's sales declined while Mr. Staekeler was pursuing other business ventures. This argument is premised upon an analysis of the daybook which, as noted, is of questionable reliability. An additional problem is that it is difficult to accept the proposition that both Mr. and Mrs. Staekeler abandoned Heros when the second operation began. It is noted that Mrs. Staekeler was at Heros during a substantial portion of the time that the observation test was being conducted.

I. Petitioners argue that the Division erred by failing to make an adjustment for inflation. Petitioners accurately point out that a comparison of the menus in the audit workpapers, obtained at different times, shows that the prices of the food offered by the delicatessen increased over time. Under the circumstances, the Division is directed to adjust its computation of additional sales tax due by an inflation factor based upon the consumer price index of the United States Department of Labor, Bureau of Labor Statistics. (*See, Matter of Sak Smoke Shop*, Tax Appeals Tribunal, January 6, 1989 [where the Tax Appeals Tribunal affirmed the determination of an Administrative Law Judge which decided that the Audit Division erred in failing to make an adjustment for inflation].)

J. According to Mr. Staekeler, when he first purchased Heros in 1995, the business was open from 7:00 A.M. to 5:00 P.M. on weekdays. Later, he began closing at 4:00 P.M. Mr. Staekeler submits that he was not open until 5:00 P.M. during the audit period, and if the Division saw activity from 4:00 P.M. to 5:00 P.M., it was unusual. Accordingly, petitioners argue that an adjustment is warranted because Heros purportedly normally closed at 4:00 P.M. Mr. Staekeler's testimony on this point is questionable. First, the worksheets prepared by the investigative aides show that the delicatessen had gross receipts of \$45.15 between the hours of

4:00 P.M. and 5:00 P.M. The report further shows that there were four employees of Heros working at the counter until 5:00 P.M. If the delicatessen's employees wished to close the establishment at 4:00 P.M., it could have been accomplished with little effort. One has to further question the reliability of Mr. Staekeler's testimony that his wife told him that the store was ready to close at 4:00 P.M. because the investigative aide's notes clearly show that she left the store on the day of the observation at 1:00 P.M. Under the circumstances, petitioners have not established by clear and convincing evidence that this adjustment is warranted.

K. Petitioners submit that an adjustment is warranted because the Division's calculations do not take into account the fact that the delicatessen closed at 3:00 P.M. on Saturdays. This argument has merit. The auditor's workpapers clearly show that the delicatessen closed at 5:00 P.M. from Monday through Friday. However, the same workpapers show that the delicatessen closed at 3:00 P.M. on Saturday. It follows that sales were overstated by attributing a full day of sales to Saturday. The investigators' workpapers show that sales were brisk during certain portions of the day and slowed down at other times. Under the circumstances, taxable sales for one day of the week should be reduced by the amount of the taxable sales observed during the hours of 3:00 P.M. to 5:00 P.M.

L. Petitioners argue that the Division never reviewed the purchase invoices given to it and as a result did not take into account the resale certificates in petitioners' possession. Contrary to the argument in petitioners' brief, the weight of the evidence is that the Division was never shown any invoices for German novelty items. Rather, it appears that these documents were given to petitioners' accountant and for some reason were never given to the auditor. At the hearing, petitioners offered a group of invoices with resale certificates attached thereto. Since no reason has been presented why the resale certificates should not be taken into account,

the Division is directed to reduce the portion of the assessment pertaining to the German novelty items by the amounts reflected by the resale certificates and the accompanying invoices.

M. Petitioners asserted that the use of the Robert Morris Associates (RMA) Survey for gift or novelty shops to determine the markup for the German novelty items was flawed because petitioners operated a delicatessen. According to petitioners, the markup on German novelty items was at most 50 percent and that most of the German novelty items were sold at wholesale. The price of the novelty items was listed on the bottom of the item. The Division has correctly noted that this argument misses the point. It is obvious that the auditor used a markup for gift or novelty shops in order to obtain comparable markup data for the novelty items. It would have been illogical to use a markup for a delicatessen on items other than food. It is noted that petitioners never produced any evidence during the audit of selling prices and, as a result, it used the only method available to it.

N. Petitioners argue that the audit was flawed because the auditor did not make any provision for ending inventory of the German novelty items in the audit methodology. This argument also lacks merit. The Division calculated the sales of the German novelty items by multiplying the estimated markup by petitioners' purchases. Inventory had no bearing on determining the amount of tax due (*see, Matter of Disanco Home Service Center Corporation*, Tax Appeals Tribunal, February 16, 1989).

O. In their reply brief, petitioners complain about the failure of the Division to call the investigative aides to testify. If petitioners wished to obtain the testimony of the investigative aides, they should have taken steps to secure their presence at the hearing (*see*, 20 NYCRR 3000.6).

P. The petitions of Juergen Staekeler and Edelweiss International, Ltd. are granted to the extent of Conclusions of Law “I,” “K” and “L”; the petitions are otherwise denied and, as modified, the notices of determination, dated July 16, 2001 and July 18, 2001, are sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
December 16, 2004

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE