STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CRONOS ENTERPRISES, INC.	:	DETERMINATION DTA NOS. 819477, 819478, 819479AND 819480
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, 1998 through February 28, 2001.	:	
In the Matter of the Petitions	:	
of	:	
STEVEN PALOUBIS, GEORGE REKKAS AND LAMBROS REKKAS	:	
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1998 through February 28, 2001.	:	

Petitioner Cronos Enterprises, Inc., 2101 Middle Country Road, Centereach, New York 11720, 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, 1998 through February 28, 2001.

Petitioner Steven Paloubis, 15 Sachem Court, Farmingville, New York 11738-2139, 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, 1998 through February 28, 2001.

Petitioner George Rekkas, 11 Elwood Drive, St. James, New York 11780-3421, 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, 1998 through February 28, 2001.

Petitioner Lambros Rekkas, 30 Miller Farm Drive, Miller Place, New York 11764-2446, 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, 1998 through February 28, 2001.

A consolidated hearing was held before Winifred M. Maloney, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on April 5, 2004 at 10:30 A.M., with all briefs to be submitted by September 17, 2004, which date began the six-month period for the issuance of this determination. Petitioner appeared by Cartier, Bernstein, Auerbach and Dazzo, P.C. (William J. Bernstein, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Michael P. McKinley, Esq., of counsel).

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioners have shown error in either the audit method or result.

II. Whether penalties imposed pursuant to Tax Law § 1145(a)(1)(i) and (vi) should be sustained.

FINDINGS OF FACT

1. Petitioners Steven Paloubis, George Rekkas and Lambros Rekkas, by their corporation, petitioner Cronos Enterprises, Inc. ("Cronos" or "the corporation"), operated a diner known as the Suffolk Diner on Middle Country Road, a very busy commercial main street surrounded by a residential area, in Centereach, Long Island. The diner is located across the street from a shopping center. Front and rear off-street parking (the "parking lot") is provided to the diner's

patrons and employees, with approximately 63 parking spaces in its parking lot. Patrons and most employees enter the diner through the two doors located at the building's front. The diner has approximately 15 to 22 tables and approximately 26 to 28 booths. Each table seats four customers and all but three of the booths accommodate four customers. Three of the booths seat only two customers. There are also seven stools at the counter. Monday through Thursday, the diner opens at 6:00 A.M. and closes the following morning at 2:00 A.M. On Friday, it closes at 2:00 A.M. and reopens at 6:00 A.M. and remains open until 2:00 A.M. on the following Monday.

2. During the period at issue, Cronos reported the following taxable sales:

Sales tax quarter ended	Taxable sales reported
Aug. 31, 1998 ("Aug-98")	$250,042.00
Nov. 30, 1998 ("Nov-98")	247,093.00
Feb. 28, 1999 ("Feb-99")	242,503.00
May 31, 1999 ("May-99")	246,125.00
Aug. 31, 1999 ("Aug-99")	247,847.00
Nov. 30, 1999 ("Nov-99")	247,165.00
Feb. 29, 2000 ("Feb-00")	268,921.00
May 31, 2000 ("May-00")	285,715.00
Aug. 31, 2000 ("Aug-00")	269,631.00
Nov. 30, 2000 ("Nov-00")	300,593.00
Feb. 28, 2001 ("Feb-01")	277,116.00
Total taxable sales reported	$2,882,751.00

3. As part of the sales tax sweep of diner restaurants operating in the county, auditors in the Suffolk County Office of the Comptroller performed an initial survey of the Suffolk Diner on April 21, 2000 and a mini-observation test on Wednesday, May 17, 2000, a sunny day with

temperatures in the 70s.[1] The mini-observation consisted of observing the breakfast (7:30 A.M. through 10:30 A.M.), lunch (11:30 A.M. through 2:30 P.M.) and dinner (4:00 P.M. through 7:00 P.M.) activity of the diner from an external point. The auditor observed a total of 324 people (107 people during breakfast hours plus 98 people during lunch hours plus 119 people during dinner hours) entering the diner during the mini-observation on May 17, 2000. Using conservative meal prices of $3.50, $6.00 and $9.00 for breakfast, lunch and dinner, respectively, and multiplying each of these prices by the number of people observed entering the diner during the corresponding meal hours, the auditor determined total observed sales of $2,033.50. Furthermore, based on the assumption that the auditor observed 75 percent of the daily business activity, he estimated the diner's daily gross sales to be $2,711.33 versus the reported daily gross sales of $2,694.90.[2] Based upon the results obtained from the mini-observation of the diner, on August 3, 2000, the Suffolk County Office of the Comptroller recommended to the Division of Taxation (the "Division") that a sales tax audit of the Suffolk Diner be performed because it appeared that the diner was underreporting gross sales.

4. The Division assigned an auditor, Elaine Sullivan, to conduct a sales tax field audit of Cronos for the period June 1, 1998 through February 28, 2001. An appointment letter dated May 4, 2001 and setting an appointment for May 31, 2001 was sent by Ms. Sullivan to Cronos. The letter requested that the corporation make available all of its books and records pertaining to its tax liability for the period under audit, including financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, sales and use tax returns, Federal income tax

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[1] The mini-observation was conducted by Mark Cagnetto, an auditor in the Suffolk County Office of the Comptroller. Mr. Cagnetto's report contains a typographical error in that it lists the date of the mini-observation as Wednesday, March 17, 2000 rather than Wednesday, May 17, 2000, the date it actually took place.

[2] A transcript of the diner's filing history was obtained from the Division of Taxation and daily gross sales were calculated using a 365 day denominator.

returns and exemption certificates. This letter, which was accompanied by an attached checklist again specifying the records required for audit, also noted that additional information might be required during the course of the audit.

5. At the written request of the corporation's representative, Steven V. Kohilakis, the field audit appointment was rescheduled for June 22, 2001. Ms. Sullivan met with Mr. Kohilakis in his office on June 22, 2001 and was provided with daily cash register tapes for the entire audit period, the accountant's monthly summary information of the diner's sales and purchases, some purchase invoices, Federal income tax returns for the entire audit period and monthly bank statements for the entire audit period. Cronos did not provide any guest checks for the audit period.

6. During the June 22, 2001 field audit appointment, Mr. Kohilakis executed a consent on behalf of the corporation extending the time for determination of sales and use taxes for the period June 1, 1998 through November 30, 1998 until March 20, 2002. Subsequently, on January 24, 2002, Mr. Kohilakis executed a consent on behalf of the corporation extending the time for determination of sales and use taxes for the period June 1, 1998 through February 28, 1999 until June 20, 2002.

7. At the June 22, 2001 field audit appointment, the auditor reviewed the daily cash register tapes for the months of August 2000 and September 2000 and determined that the cash register tapes were unreliable because there was no machine-printed date (only a handwritten date) and no daily opening transaction number on each tape; there were sequential transaction numbers missing from the tapes for both months and, the number of daily transactions listed on the tapes appeared low and the dollar amount per transaction appeared high, i.e., the average number of transactions was 121 in August 2000 (3,762 divided by 31 days) and 139 in

September 2000 (4,172 divided by 30 days) and the average transaction amount was $25.30 and $25.45, respectively, during August 2000 and September 2000. At that time, the auditor also noted that the individual transaction amounts listed on the cash register tapes were not equally divisible by 1.0825. In addition, the auditor was unable to verify that all the transaction amounts were listed on the cash register tapes because guest checks necessary to cross-check the transaction amounts were not supplied to her. Therefore, the auditor concluded that the cash register tapes provided by Cronos were not adequate to determine taxable sales. During that field audit appointment, the auditor had a conversation with Mr. Kohilakis regarding the necessity for an observation of the diner to take place.

8. By letter dated June 25, 2001, the auditor confirmed her recent conversation with Mr. Kohilakis regarding the necessity to perform an observation of his client's business within the next six weeks. She advised him that the sales activity would "be recorded for an entire day, from opening to closing" and the observation would "be performed discretely [sic], with minimal interruption of business activity." On July 2, 2001, Mr. Kohilakis sent the auditor a written response, in which he stated that Cronos's corporate officers were "opposed to the proposed observation. Please, arrange for alternative course of action to conclude tins [sic] audit."

9. To determine the reliability of the purchasing information provided by the corporation, Ms. Sullivan sent purchase confirmation letters, dated June 25, 2001, to two of the diner's suppliers, Peerless Importers, Inc. (a liquor supplier) and Clare Rose, Inc. (the Budweiser supplier on Long Island). Both suppliers responded within a week and reported sales to Cronos during the period January 1, 2000 through November 30, 2000 in amounts greater than the amount of purchases Cronos had recorded in its books from these suppliers for the same period.

As a result, the auditor determined that the purchase information provided by Cronos was unreliable and thus not adequate to determine sales.

10. The auditor concluded that the books and records provided by the corporation were inadequate and insufficient to determine the diner's taxable sales.

11. Normally, an investigator conducts an observation test inside an establishment and records its sales activity on a tally sheet. For each sales transaction, the investigator would record the following information on the tally sheet: the time, the type of transaction (cash or charge), the guest check number, the head count, the total amount of the transaction, the food and drink amount, the nontaxable amount and the tip amount. When an observation test is performed from outside an establishment, the time and number of customers who enter the premises (i.e., the head count) are recorded by the investigator on the tally sheet. Employees, delivery people, individuals entering and leaving quickly and children under the age of five are not included in the head count. To denote that a group of people entered the premises, the investigator would circle the number he recorded on the tally sheet.

12. On June 25, 2001, the auditor sent an observation request to the investigators. On this request, she wrote: "Friday open 24 hrs. - will probably be from outside will let you know - if so need head count & transaction count - see me." A Friday was selected for the observation test for the following reasons. The Division wanted a test day that the Suffolk Diner was open 24 hours and Friday and Saturday were the only days of the week that the diner was open 24 hours. Based on her audit experience that Saturday was the busiest day of the week for diners, the auditor chose Friday for the observation test. She believed Friday was a relatively representative day for the Suffolk Diner.

13. The observation request was forwarded to an investigator supervisor, Linda Caracappa, who scheduled the all-day observation of Suffolk Diner for August 10, 2001 based upon her schedule and the auditor's request that the test be conducted on a Friday. The Division assigned three investigators, Richard Graff, Linda Loesch and Ms. Caracappa, to cover the 24-hour period from 6:00 A.M. on Friday, August 10^{th} through 6:00 A.M. on Saturday, August 11^{th}. Ms. Caracappa was Ms. Loesch's supervisor. Mr. Graff was an intern under another person's supervision, but he was assigned to assist in the investigation. Even though Mr. Graff had prior training in the performance of observation tests, in preparation for the observation of the Suffolk Diner, Ms. Caracappa gave him instructions on how to perform an observation test from outside. Specifically, she told Mr. Graff "to go out and do [the observation] with the circling," i.e., do a head count, if the test could not be performed from inside the diner.

14. On Friday, August 10, 2001, the observation of the diner was commenced within the premises at 6:00 A.M. by Mr. Graff. However, he was asked by George Rekkas to leave the premises at 7:27 A.M., and he continued to conduct the observation by head count only from outside in the parking area located in front of the diner. A review of Mr. Graff's tally sheets reveal his handwritten notation "kicked out @ 7:27 A.M." The second investigator, Ms. Loesch, continued the observation of the diner by head count only from the parking area located in front of the diner from 12:15 P.M. until 9:15 P.M., and the third investigator, Ms. Caracappa, continued the observation in the same manner from the parking area located in front of the diner from 9:15 P.M. until 6:00 A.M. on Saturday, August 11^{th}. The investigators did not take any bathroom breaks while conducting the observation test of the Suffolk Diner.

15. August 10, 2001 was a typical hot summer day with temperatures in the 80s. The investigators noted that there were thunder and lightening storms with heavy rain beginning at

approximately 3:15 P.M. in the afternoon and lighter rain continuing on and off throughout the evening until about 9:00 P.M. They further noted that at about that time, the rain stopped but it continued to be cloudy with temperatures in the 80s.

16. During the 24-hour observation test, the investigators counted and recorded on the tally sheets a total of 1,294 people entering the diner. The investigators did not count employees, delivery people, children under the age of five or people who were only inside the diner for a few minutes. They also noted on the tally sheets takeout orders, deliveries (i.e., supplier names) and the arrival and departure of the diner's waiters and waitresses. The report of the 24-hour observation test was forwarded along with the investigators' tally sheets to the auditor.

17. The auditor reviewed the head count recorded on the investigators' tally sheets and sorted the customers by time intervals from 6:30 A.M. on Friday, August 10, 2001 until 6:00 A.M. on Saturday, August 11, 2001. Next, the auditor divided the day into four meal segments (i.e., breakfast, lunch, dinner and other) based upon the time intervals and determined the following number of customers entered the diner during each meal segment.

Breakfast - - between 6:30 A.M. and 11:00 A.M. (Friday) - -	133 customers
Lunch - - between 11:00 A.M. and 3:00 P.M. (Friday) - -	238 customers
Dinner - - between 3:00 P.M. and 9:00 P.M. (Friday) - -	481 customers
Other - - between 9:00 P.M. (Friday) and 6:00 A.M. (Saturday) - -	442 customers
Total during the 24-hour observation period	1,294 customers

18. A review of the Tax Field Audit Record ("audit log") reveals that, on September 20, 2001, the auditor met with the corporation's accountant and discussed the observation data. The audit log further reveals that, on or about October 26, 2001, the corporation's accountant

supplied a menu, currently in use when supplied, which the auditor used to compute the diner's estimated daily sales figures.

19. The auditor computed the diner's estimated taxable sales for the test day in the following manner. First, the auditor estimated an average taxable sale per customer for each meal segment using the diner's menu. For the breakfast segment, the auditor averaged the cost of five breakfast specials that included coffee or tea and determined an average taxable sale per person of $5.79. For the lunch segment, she averaged the cost of six meals and determined an average taxable sale per person of $9.53. For the dinner segment, the auditor averaged the cost of four meals and determined an average taxable sale per person of $16.06 and for the other segment, she averaged the cost of three meals and a dessert and determined an average taxable sale per person of $7.75. For the lunch, dinner and other segments, the auditor included the price of a drink (the average of the price of coffee and soda, i.e., $1.15) in the cost of each meal averaged. The auditor assumed that french fries (the average of the price of regular and curly fries, i.e., $3.05) were ordered by half of the lunch customers and she included the average price of the fries in the cost of three of the six meals averaged for the lunch segment. She assumed that either an appetizer or a dessert costing $3.50 was ordered by half of the dinner customers and included that cost in two of the four meals averaged for the dinner segment. Next, the auditor multiplied the average price for each meal segment by the number of customers entering the diner during the corresponding time interval, then added the estimated taxable sales for each of the four segments together to arrive at total estimated taxable sales of $13,967.57 (rounded to $13,968.00) for the Friday test day.[3]

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[3] Estimated taxable sales for the test day were computed as follows: the breakfast segment, 133 customers times $5.79 equals $770.07; the lunch segment, 238 customers times $9.53 equals $2,268.14; the dinner segment, 481 customers times $16.06 equals $7,724.86; the other segment, 442 customers times $7.25 equals $3,204.50. ($770.07 + $2,268.14 + $7,724.86 + $3,204.50 = $13,967.57).

20. The auditor estimated taxable sales for each of the remaining six days of the week as follows. She assumed that the estimated taxable sales for Saturday equaled $13,968.00, the amount of estimated taxable sales determined for Friday, because the diner was open 24 hours on Saturday. To account for the four fewer hours that the diner was open on Sunday (i.e., it closed at 2:00 A.M. on Monday mornings), the auditor calculated Sunday estimated taxable sales in the following manner. Using the observation data, she determined that 125 people entered the diner between 2:00 A.M. and 6:00 A.M. on the test day. Next, the auditor multiplied 125 customers by $7.25, the average taxable sale per person during the other segment that included the 2:00 A.M. and 6:00 A.M. time period, to arrive at $906.00. Then, she reduced Friday estimated taxable sales of $13,968.00 by $906.00 and determined Sunday estimated taxable sales to be $13,062.00. For each of the weekdays, Monday through Thursday, when the diner was open 20 hours a day, the auditor assumed that estimated taxable sales were 60 percent of Sunday estimated taxable sales of $13,062.00 or $7,837.00 ($13,062.00 times .60 equals $7,837.20, rounded down to $7,837.00) per day. She based this assumption upon the ratio of the number of people observed entering the diner during the mini-observation test conducted by Suffolk County on Wednesday, May 17, 2000, of 324 divided by the number of people observed entering the diner during the comparable hours, (i.e., breakfast hours: 7:30 A.M. through 10:30 A.M., lunch hours: 11:30 A.M. through 2:30 P.M. and dinner hours: 4:00 P.M. through 7:00 P.M.), on the Division's test day, August 10, 2001, of 541 (324 divided by 541 equals 60 percent).

21. By adding the estimated taxable sales amounts determined for each day of the week together, the auditor determined estimated weekly taxable sales to be $72,345.00.[4] Then, the

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[4] $13,968.00 (Fri. est. taxable sales) plus $13,968.00 (Sat. est. taxable sales) plus $13,062.00 (Sun. est. taxable sales) plus $7,837.00 (Mon. est. taxable sales) plus $7,837.00 (Tues. est. taxable sales) plus $7,837.00 (Wed. est. taxable sales) plus $7,837.00 (Thurs. est. taxable sales) equals $72,345.00 in weekly estimated taxable sales.

auditor multiplied estimated taxable weekly sales of $72,345.00 by the 13 weeks in the quarter to arrive at estimated quarterly taxable sales of $940,481.00. Next, the auditor adjusted the estimated taxable sales for each quarter by the Consumer Price Index ("CPI") to account for price increases on the menu during the audit period. The auditor adjusted the menu prices for inflation because the audit period began on June 1, 1998 and the menu prices were as of August 2001. The auditor then subtracted taxable sales reported by the corporation during each quarter in the audit period from the adjusted taxable sales for each quarter to arrive at additional taxable sales for each quarter. She then multiplied the additional taxable sales determined for each quarter by the sales tax rate of 8.25 percent to arrive at the additional sales tax due for each quarter in the audit period. The auditor computed additional taxable sales of $6,887,907.00 and additional sales tax due of $568,252.34 for the period June 1, 1998 through February 28, 2001 as follows:

Quarter Ended	Audited Quarterly Sales	Inflation Factor P CPI	Adjusted Taxable Sales	Taxable Sales Reported	Additional Taxable Sales	Additional Tax Due @ 0.0825
Aug-98	$940,481.00	0.089	$856,778.00	$250,042.00	$606,736.00	$50,055.72
Nov-98	$940,481.00	0.084	$861,481.00	$247,093.00	$614,388.00	$50,687.01
Feb-99	$940,481.00	0.082	$863,362.00	$242,503.00	$620,859.00	$51,220.87
May-99	$940,481.00	0.069	$875,588.00	$246,125.00	$629,463.00	$51,930.70
Aug-99	$940,481.00	0.066	$878,409.00	$247,847.00	$630,562.00	$52,021.37
Nov-99	$940,481.00	0.056	$887,814.00	$247,165.00	$640,649.00	$52,853.54
Feb-00	$940,481.00	0.053	$890,636.00	$268,921.00	$621,715.00	$51,291.49
May-00	$940,481.00	0.037	$905,683.00	$285,715.00	$619,968.00	$51,147.36
Aug-00	$940,481.00	0.028	$914,148.00	$269,631.00	$644,517.00	$53,172.65
Nov-00	$940,481.00	0.021	$920,731.00	$300,593.00	$620,138.00	$51,161.39
Feb-01	$940,481.00	0.026	$916,028.00	$277,116.00	$638,912.00	$52,710.24

Totals	$10,345,291.00	$9,770,658.00	$2,882,751.00	$6,887,907.00	$568,252.34

22. A review of the audit log reveals that, unable to reach him by telephone on October 26, 2001, the auditor left Mr. Kohilakis a voice mail message concerning her computations of additional taxable sales and additional tax due and recommending that his client consider allowing the Division to conduct a weekday observation test. The audit log further reveals that the auditor met with Mr. Kohilakis on November 1, 2001 to discuss the August 10, 2001 observation test and audit results, but there was no agreement. According to the audit log, the corporation's representative called the auditor on November 20, 2001 and stated that he would check with his client about the observation test and the audit findings.

23. The audit log and the Field Audit Report ("audit report") indicate that a Statement of Proposed Audit Change (form AU 346) was issued to Cronos on December 7, 2001 that proposed additional tax due in the amount of $568,252.34 plus penalties and statutory interest. The proposed penalties on the statement were computed pursuant to Tax Law § 1145(a)(1)(i) and (vi).

24. The corporation's representative disagreed in writing with the proposed audit change. The auditor met with the corporation's representative on January 2, 2001 to discuss the audit findings. The audit log indicates that the representative was given a deadline of January 15, 2002 to supply any documentation. The audit log further reveals that on January 24, 2002, during a telephone conversation initiated by the auditor, the corporation's representative requested additional time to supply documentation. On February 8, 2002, the auditor met with the representative to discuss the audit findings. However, he did not offer any documentation to refute the findings. Furthermore, the Division offered to perform a second observation test but the corporation's representative declined that offer.

25. On February 25, 2002, the Division issued to Cronos Enterprises, Inc., a Notice of Determination (Notice No. L-020654276-7) for sales and use taxes in the amount of $568,252.34, plus penalties of $217,892.13 and interest of $172,614.35, for a current balance due of $958,758.82, for the period June 1, 1998 through February 28, 2001. The computation section of the Notice of Determination contained the following explanation: "Based on our audit of your records, we determined that you owe tax, interest, and any applicable penalties, under sections 1138 and 1145."

On February 25, 2002, the Division also issued three additional notices of determination. The Division issued to Steven Paloubis, as an officer or responsible person of Cronos Enterprises, Inc., a Notice of Determination (Notice No. L-020661600-5) for sales and use taxes in the amount of $467,509.61, plus penalties of $177,595.04 and interest of $123,575.15, for a current balance due of $768,679.80, for the period December 1, 1998 through February 28, 2001. The Division issued to George Rekkas, as an officer or responsible person of Cronos Enterprises, Inc., a second Notice of Determination (Notice No. L-020661601-4) for sales and use taxes in the amount of $467,509.61, plus penalties of $177,595.04 and interest of $123,575.15, for a current balance due of $768,679.80, for the period December 1, 1998 through February 28, 2001. The Division issued to Lambros Rekkas, as an officer or responsible person of Cronos Enterprises, Inc., a third Notice of Determination (Notice No. L-020661599-4) for sales and use taxes in the amount of $467,509.61, plus penalties of $177,595.04 and interest of $123,575.15, for a current balance due of $768,679.80, for the period December 1, 1998 through February 28, 2001.[5]

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[5] Although Cronos was assessed sales and use taxes for 11 quarters, the responsible officers were assessed for 9 tax quarters because Mr. Kohilakis executed consents to extend the period of limitation to assess sales and use taxes on behalf of the corporation only.

26. Each of the statutory notices herein assessed penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi). Both statutory and omnibus penalties were assessed because the additional tax due is more than 25 percent of the audited tax due.

27. Petitioners filed requests for conciliation conference with the Bureau of Conciliation and Mediation Services. After a conciliation conference, the conferee sustained the statutory notice (Notice No. L020654276) issued to Cronos in an Order (CMS No. 191417) dated February 28, 2003. After a conciliation conference, the conferee also sustained the statutory notices (Notice numbers L020661600, L020661601 and L020661599) issued to Steven Paloubis, George Rekkas and Lambros Rekkas, respectively, in conciliation orders (CMS nos. 191419, 191420 and 191418, respectively) dated February 28, 2003.

28. On May 14, 2003, each petitioner filed a timely petition for review of the Notice of Determination with the Division of Tax Appeals.

29. Petitioners' representative stipulated on the record that Steven Paloubis, George Rekkas and Lambros Rekkas were responsible officers of Cronos Enterprises, Inc. and their status as responsible officers of that corporation was not an issue in dispute.

30. Along with its brief, the Division submitted 12 pages of unnumbered proposed findings of fact, relevant portions of which have been incorporated herein. Even though State Administrative Procedure Act § 307(1) requires a ruling "upon each proposed finding of fact," because the Division did not separately number each of its proposed findings of fact, they have not been ruled upon.

SUMMARY OF PETITIONERS' POSITION

31. At the hearing, Steven Paloubis and George Rekkas, two of the diner's owners, testified about the operation of the diner in general and that the date of the observation test,

Friday, August 10, 2001, was unusual. Mr. Paloubis and George and Lambros Rekkas have owned the Suffolk Diner for approximately ten years. Both Mr. Paloubis and George Rekkas explained that an owner is always present overseeing the diner's operation during business hours. According to Messrs. Paloubis and Rekkas, numerous electrical blackouts and brownouts were experienced by homes and other businesses in the area of the diner on August 10, 2001 and these blackouts caused the diner's business to increase. They claimed that the electrical blackouts did not affect the diner which had lights, air conditioning and the ability to cook food. Messrs. Paloubis and Rekkas further claimed that on that particular Friday the diner did significantly more business than on a normal Friday in the summer. Neither man identified the specific amount of the claimed increase in business experienced by the diner on August 10, 2001. In support of their position that numerous electrical blackouts affected the area on the date of the observation test, petitioners obtained and submitted a letter from the Long Island Power Authority that confirmed "that towns including Hauppauge, Lake Grove, Selden and Centereach experienced temporary power outages due to extreme weather related conditions (heat) throughout the day and evening of August 10, 2001."

32. At the hearing, Messrs. Paloubis and Rekkas claimed that the observation test day was atypical and the assessment was overstated for a number of reasons. First, they claimed that sometimes the diner closes earlier than its scheduled hours due to the lack of customers. According to Messrs. Paloubis and Rekkas, the diner's early closings depended upon holidays and weather conditions. Specifically, they maintained that the diner closed early on the following holidays, among others, Memorial Day, July 4th, Labor Day, Rosh Hashanah, Yom Kippur, Columbus Day, Veteran's Day, Thanksgiving Day, New Year's Day, Good Friday and Easter. In the case of Christmas, Messrs. Paloubis and Rekkas claimed that the diner closed at

about 10:00 P.M. on Christmas Eve and reopened on December 26th at 6:00 A.M. Mr. Rekkas estimated that 10 to 13 days a year the diner closed early because of adverse weather conditions, such as snow storms and icy road conditions. Next, Messrs. Paloubis and Rekkas claimed that community events, i.e., parades, marathons and road work, reduced business. Mr. Rekkas estimated that five or six times a year business was reduced because of community events. Next, Mr. Paloubis claimed that summer is a little bit busier than the rest of the year. Next, both Mr. Paloubis and Mr. Rekkas claimed that sales activity varied by the day of the week. Specifically, they maintained that Friday is the diner's busiest day of the week; Saturday's sales activity is about 80 percent of Friday's sales activity; Sunday's sales activity is about 60 percent of Friday's sales activity; Thursday's sales activity is about 60 percent of Friday's sales activity and the lowest sales activity occurs on Monday, Tuesday and Wednesday, each day's sales activity is about 50 percent of Friday's sales activity. Both Mr. Paloubis and Mr. Rekkas claimed that at some point, the diner was expanded to provide a nonsmoking area containing about 35 seats.[6] Mr. Paloubis also claimed that the average meal price used by the Division for the breakfast segment was too high because many people order only coffee and a muffin instead of a full breakfast. Lastly, Mr. Paloubis claimed that on an average day, there are about 20 to 25 employees, 10 delivery people and other people entering the premises through the front doors who are not customers.

33. Cronos retained Alvin Silverman, a certified public accountant ("CPA"), to represent it in connection with a second audit, for the period March 1, 2001 through November 30, 2003, commenced by the Division upon receipt of a bulk sale notice. Subsequently, petitioners

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[6] Neither Mr. Paloubis nor Mr. Rekkas could recall whether the expansion occurred during the audit period or subsequent to the audit period, but prior to August 10, 2001, the date of the observation test.

requested that he become involved with the present matter. At the hearing, Mr. Silverman testified about his analysis of some of the corporation's records and the audit conclusions reached by the Division, in connection with its subsequent audit for the period March 1, 2001 through November 30, 2003.

34. Mr. Silverman claimed that he was provided with all of the diner's cash register tapes and guest checks for every day of the month of July 2003. Based upon his analysis of these cash register tapes and guest checks, Mr. Silverman determined that average daily sales for Fridays in July 2003 were $5,505.76; and, that the corporation's average weekly sales for July 2003 were $25,560.01. His analysis also revealed that, during July 2003, Saturday sales were approximately 80 percent of Friday sales, Thursday and Sunday sales were approximately 66 percent of Friday sales, Monday sales were 50.76 percent of Friday sales, Tuesday sales were 53.90 percent of Friday sales and Wednesday sales were 46.74 percent of Friday sales.

35. Mr. Silverman claimed that he was provided with all of the diner's cash register tapes for the period March 1, 2002 through December 23, 2002.[7] Based upon his analysis of these cash register tapes, Mr. Silverman determined that average daily sales for Fridays during the period March 1, 2002 through December 23, 2002 were $5,993.79; and average weekly sales during this period were $27,837.24. His analysis also revealed that, during the period March 1, 2002 through December 23, 2002, Saturday sales were approximately 84 percent of Friday sales, Thursday and Sunday sales were approximately 65 percent of Friday sales, Monday sales were 49.46 percent of Friday sales, Tuesday sales were 52.61 percent of Friday sales and Wednesday sales were 47 percent of Friday sales.

[7] The cash register tape and sales information for Sunday, December 22, 2002 is missing.

36. According to Mr. Silverman, he was provided with all of the guest checks for two days in June 2003, i.e., Saturday, June 21, 2003 and Tuesday, June 24, 2003. For each of these days, Mr. Silverman added up the total amount listed on each check and arrived at total gross sales (including tax) of $4,811.74 and $3,050.03, respectively, for Saturday, June 21, 2003 and Tuesday, June 24, 2003, respectively.

37. Petitioners also submitted information about a subsequent observation test conducted by the Division on Friday, January 23, 2004 for a sales tax audit of Cronos, for the period March 1, 2001 through November 30, 2003, commenced upon receipt of the bulk sale notice. The observation test consisted of observing the breakfast (7:30 A.M. through 10:30 A.M.), lunch (11:30 A.M. through 2:30 P.M.) and dinner (4:00 P.M. through 7:00 P.M.) activity of the diner from outside. The next day, Mr. Silverman allegedly obtained all of the diner's guest checks and the cash register tape for January 23, 2004 and he submitted these items to the auditor working on this subsequent audit. It appears from review of the auditor's workpapers that, after analyzing the results of the observation test, the guest checks and the cash register tape for Friday, January 23, 2004, she determined that there were 688 customers, total receipts including tax of $6,002.73 and taxable sales of $5,519.75 that day. The auditor determined weekly taxable sales to be $29,254.69 and monthly taxable sales to be $125,795.75 for the months of December, January and February. For the period December 1, 2001 through February 28, 2002, the auditor determined audited taxable sales to be $377,385.45. For the period December 1, 2002 and February 28, 2003, audited taxable sales were determined to be $377,385.45 as well. For the remaining quarters in the audit period, the auditor used the results of the August 10, 2001 observation test in her computations. At the hearing, Mr. Silverman admitted that if the proposed audit adjustment from the subsequent audit was accurate, the corporation had still

underreported sales tax by about 30 percent for the period December 1, 2001 through February 28, 2002.

38. In their brief, petitioners argue that the records analyzed by Mr. Silverman as supported by the mini-observation test conducted by Suffolk County on May 17, 2000 and the second full observation test conducted by the Division on January 23, 2004 show that the corporation's taxable sales for the period June 1, 1998 through February 28, 2001 were $3,559,719.46 and additional tax due should be computed accordingly. Their computation of taxable sales for the period at issue follows:

Friday Sales	$ 5,519.75
Saturday Sales (80 percent of Friday sales)	4,415.80
Sunday Sales (66 percent of Friday sales)	3,643.03
Monday Sales (50 percent of Friday sales)	2,759.88
Tuesday Sales (50 percent of Friday sales)	2,759.88
Wednesday Sales (50 percent of Friday sales)	2,759.88
Thursday Sales (66 percent of Friday sales)	3,643.03
Weekly Sales	$25,501.25
Monthly Sales ($25,501.25 times 4.23 weeks)	$107,870.28
Quarterly Sales ($107,870.28 times 3 months)	$323,610.86
Taxable sales for audit period ($323,610.86 times 11 quarters)	$3,559,719.46

39. In their brief, petitioners also argue that since their computation of taxable sales in the amount of $3,559,719.46 for the period June 1, 1998 through February 28, 2001 exceeds the corporation's reported taxable sales of $2,882,751.00 for the same period by only 19 percent, no penalties and only minium interest should be imposed.

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][A]). Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is 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. The original appointment letter sent by the Division to Cronos constituted an adequate request for books and records and covered the entire audit period currently at issue. The corporation provided daily cash register tapes for the entire audit period, monthly summary information of its sales and purchases, some purchase invoices, Federal income tax returns and monthly bank statements for the entire audit period. After reviewing the daily cash register tapes for two months, i.e., August 2000 and September 2000, the auditor determined that the cash register tapes were unreliable because there was no machine-printed date and no daily opening transaction number on each tape; there were sequential transaction numbers missing from the tapes for both months; the daily number of transactions on the tapes appeared low and the dollar amount per transaction appeared high and, the individual transaction amounts were not equally divisible by 1.0825. No guest checks were supplied to the auditor. The unreliability of the cash register tapes and the lack of guest checks clearly establishes that the auditor correctly concluded that the source documentation provided by the corporation was inadequate. In addition, the auditor sent purchase confirmation letters to two of the corporation's suppliers. Both suppliers reported sales to Cronos greater than the amount of purchases recorded on its books. The auditor correctly determined that Cronos's purchase records were inadequate to estimate the tax liability because of the unreliability of the corporation's purchase records (***see, Matter of Roebling Liquors v. Commissioner of Taxation & Finance***, 284 AD2d 669, 728 NYS2d 509, 512, ***appeal dismissed*** 97 NY2d 637, 735 NYS2d 493, ***cert denied*** 537 US 816, 154 L Ed 2d 20). Petitioners have not asserted that the Division did not make an adequate request for books and records or that they submitted adequate books and records to the Division. Since the books and records provided by Cronos were clearly not adequate to substantiate its reported sales, the Division was justified in estimating the corporation's sales tax liability using indirect audit methodologies in this case. The courts have upheld the use of observation tests on numerous occasions (***see, Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance***, 205 AD2d 989, 613 NYS2d 967; ***Matter of Sarantopoulos v. Tax Appeals Tribunal***, 186 AD2d 878, 522 NYS2d 102; ***Matter of Vebol Edibles v. Tax Appeals Tribunal***, 162 AD2d 765, 577 NYS2d 678, ***lv denied*** 77 NY2d 803, 567 NYS2d 643); ***Matter of Club Marakesh v. State Tax Commission***, 151 AD2d 908, 542 NYS2d 881, ***lv denied*** 74 NY2d 616, 550 NYS2d 276; and ***Matter of Meskouris Bros., Inc. v. Chu***, 139 AD2d 813, 526 NYS2d 679). Furthermore, it is reasonable to extrapolate the results of a one-day observation test over a multi-year audit period. (***See***, ***Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance, supra; Matter of Lombard v. Commr. of Taxation and Finance***, 197 AD2d 799, 602 NYS2d 972; ***Matter of Marte***, Tax Appeals Tribunal, August 5, 2004; ***Matter of Himed Deli Corp.***, Tax Appeals Tribunal, March 30, 2000.)

D. Where, as in the instant matter, resort to an observation test audit is appropriate, the burden of proof lies with the taxpayer to show by clear and convincing evidence that the audit method was unreasonable or that the results were unreasonably inaccurate (***see, Matter of Meskouris Bros. v. Chu, supra****;* ***Matter of Surface Line Operators Fraternal Org. v. Tully, supra***).

E. Petitioners contend that the Division's audit methodology was flawed for a number of reasons. First, petitioners contend that the Division acted unreasonably when it assigned Mr. Graff as the first investigator conducting the observation test on Friday, August 10, 2001. Petitioners claim that, as an intern, Mr. Graff lacked the training necessary to be the first investigator observing the diner's sales activity. They further claim that a more experienced investigator would have explained to Mr. Rekkas the consequences of the Division's conducting the observation test from outside the diner and would have convinced Mr. Rekkas to allow him to continue the observation test inside the diner. The record does not support petitioners' claim that Mr. Graff lacked the necessary training to conduct either an inside or an outside observation test of the diner. Notwithstanding the fact that Mr. Graff had received prior training in the performance of an observation test, the investigator supervisor assigned to the observation test, Ms. Caracappa, credibly testified that she gave him instructions on how to perform an observation test from outside the premises. Furthermore, I have reviewed the observation test tally sheets and I do not find any difference in the manner in which Mr. Graff recorded the findings and that used by the other two investigators. The record also belies petitioners' argument that a more experienced investigator would have convinced Mr. Rekkas to allow the observation test to continue inside the diner. On July 2, 2001, the corporation's accountant informed the auditor that the corporate officers were opposed to the proposed observation test.

Mr. Rekkas's actions on August 10, 2001 were consistent with that prior written statement. Furthermore, after the observation test, the auditor met with the accountant, discussed the test results and offered to conduct another observation test. However, that offer was declined. Therefore, petitioners must bear the consequences of the actions of one of the corporate officers.

Second, petitioners claim that the investigators included employees, delivery people and others who were not actually customers in the head count performed on the test day. This claim is without merit. Ms. Caracappa credibly testified that the investigators did not count employees, delivery people, children under the age of five, or individuals who entered and exited the premises quickly. In addition, the investigators noted delivery people and the arrival and departure of waiters and waitresses on the tally sheets.

Third, petitioners assert that the customer count was overstated because the diner had significantly more business on August 10, 2001 due to rolling electrical blackouts and brownouts in the area of the diner. They contend that homes in the area did not have power, but the diner did, so many people came to the diner for its air conditioning and food because the people did not have power at home. In support of their assertion, petitioners presented a letter from Long Island Power Authority and the testimony of Mr. Paloubis and George Rekkas. The letter from the Long Island Power Authority does not establish that the weather conditions on August 10, 2001 had any affect on the number of customers the diner had that day. That letter simply states that Centereach, among other towns, experienced temporary power outages due to extreme weather related conditions (heat) throughout the day and evening of August 10, 2001. It fails to identify the areas within Centerreach affected by the electrical blackouts, the number and duration of these blackouts or the time periods when they occurred. As for the testimony of Mr. Paloubis and George Rekkas, I find their testimony to be extremely vague. Although Messrs.

Paloubis and Rekkas both claimed that the diner did significantly more business that particular Friday than on a normal Friday in summer, neither man was able to identify the specific amount of the claimed increase in business experienced by the diner on August 10, 2001. Their vague claims that the diner did significantly more business on Friday, August 10, 2001, are insufficient to prove that the observation test conducted that day was flawed. I also find it incredible that the corporation did not agree to have another observation test performed, if the sales activity on the observation test day was, in fact, unusual.

In sum, petitioners have failed to show by clear and convincing evidence that the audit method employed by the Division was unreasonable (***see, Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra***).

F. Petitioners also attack the assumptions and calculations made by the auditor in conducting the audit. They assert that the auditor did not take certain factors into account when she estimated the tax liability and, therefore, the audit method utilized by the Division is flawed. First, petitioners claim that the auditor failed to adjust taxable sales for days that the diner was closed, or did less business because of holidays, weather conditions and community events. Petitioners assert that the testimony of Messrs. Paloubis and Rekkas clearly establishes that at a minimum 30 days out of the year were significantly slower than average. They also claim that the audit is erroneous because the auditor did not adjust audited daily taxable sales sufficiently for variations in business on different days of the week. Petitioners maintain that the assumptions the auditor made concerning the percentage variations in the diner's daily sales activity are unreasonable. They argue that the sworn testimony of Messrs. Paloubis and Rekkas, supported by the analysis done by their expert, Mr. Silverman, clearly establishes that Fridays were by far Cronos's busiest day, followed by Saturdays, which had 80 percent of the Friday business, then by Sunday and Thursday, at about 66 percent of the Friday business and then Monday through Wednesday, at about 50 percent of the Friday business. Third, petitioners dispute the average meal prices used by the auditor to compute the audited daily taxable sales because the auditor made assumptions about what customers ordered and obtained prices from the diner's menu. They claim that the average meal price for the breakfast segment was too high because Mr. Paloubis's testimony clearly establishes that many customers order only coffee and a muffin instead of a full breakfast.

G. The determination of whether the method chosen by the Division was reasonable is based on the information available to the Division at the time of the issuance of the notice (***see, Matter of Continental Arms Corp. v. State Tax Commn.***, 72 NY2d 976, 534 NYS2d 362; ***Matter of Northern States Contracting Co.***, Tax Appeals Tribunal, February 6, 1992). The record establishes that, after reviewing the books and records and determining they were inadequate, the auditor concluded that an observation test of the corporation's sales activity was necessary. The Division wanted a test day that the diner was open 24 hours and Friday and Saturday were the only days of the week that the diner was open 24 hours. Based on her audit experience that Saturday was the busiest day of the week for diners, the auditor chose Friday for the observation test. She believed Friday was a relatively representative day for the Suffolk Diner. 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 Commn.***, 88 AD2d 1028, 451 NYS2d 900, ***appeal dismissed*** 57 NY2d 954, 457 NYS2d 1028). Although the 24-hour observation test began within the diner on August 10, 2001, the first investigator was asked by George Rekkas to leave the premises at 7:27 A.M. The investigators conducted the remainder of the observation test from outside the diner. As a result, the Division was able to get a head count of the diner's customers but it was unable to ascertain what they ordered. The observation test and the audit were completed as noted in Findings of Fact "14" through "21." The record reflects the auditor's efforts to discuss her audit findings with the corporation's representative from the time of the observation test on August 10, 2001 until February 25, 2002, the date the notices of determination were issued. During this six-month period, the auditor met with the corporation's representative four times, i.e., September 20, 2001, November 1, 2001, January 2, 2002 and February 8, 2002. Several telephone conversations also took place between the auditor and the corporation's representative. However, the representative did not provide any information or comment about the audit methodology to the Division at any of these meetings or during the course of any of these telephone conversations. Furthermore, during this time period, the Division's offers to perform another observation test were declined by the corporation's representative. Based upon the information available to the Division at the time the notices were issued, I find that the audit method utilized was reasonable (***Matter of Continental Arms Corp. v. State Tax Commn.***, ***supra; see also, Matter of Northern States Contracting Co.***, ***supra***).

H. In their brief, petitioners claim that the testimony of Mr. Silverman, the CPA they hired to help resolve a subsequent audit, and his analysis of cash register tapes and guest checks for the month of July 2003 and the cash register tapes for the period March 1, 2002 through December 23, 2002 clearly establish that Friday was the diner's busiest day of the week; Saturday's sales activity was 80 percent of Friday's sales activity; Sunday's and Thursday's sales activity was approximately 66 percent of Friday's sales activity and Monday through Wednesday sales activity was 50 percent of Friday's sales activity. Petitioners further claim that Mr. Silverman's analysis of the diner's sales activity confirms the testimony of Mr. Paloubis and

George Rekkas on the same point. They argue that Mr. Silverman's analysis also clearly shows that the diner's average weekly taxable sales were significantly lower than the estimated weekly taxable sales determined by the auditor who used the results of the August 10, 2001 observation test in her computations. During the hearing, Mr. Silverman also submitted some workpapers from the Division's subsequent audit of Cronos. Petitioners maintain that the results of the Division's full observation test conducted on Friday, January 23, 2004, in connection with that subsequent audit, more accurately reflect the diner's sales activity on a Friday. They argue that the results of that subsequent observation test should be used in the present matter to compute the corporation's taxable sales for the period June 1, 1998 through February 28, 2001 rather than the results from the August 10, 2001 observation test used by the auditor. In their brief, petitioners have recomputed the taxable sales for the period June 1,1998 through February 28, 2001 using the records analyzed by Mr. Silverman as supported by the mini-observation test conducted by the Suffolk County Office of the Comptroller on May 17, 2000 and the subsequent observation test conducted by the Division on January 23, 2004. According to petitioners' recomputation, taxable sales for the period in issue would total $3,559,719.46 and additional taxable sales would total $676,968.46 ($3,559,719.46 less $2,882,751.00 in reported taxable sales equals $676,968.46). They request that the additional tax due for the period in issue be recomputed accordingly.

I. Petitioners' argument that the auditor failed to adjust her estimates of daily sales activity sufficiently for variations in business activity on different days of the week is without merit. I find that the auditor's estimates of daily sales activity were reasonable. Prior to the issuance of the notices of determination at issue, the auditor discussed the audit findings with the corporation's representative on a number of occasions. However, he did not make any comments about, or supply any documentation pertaining to, either the corporation's daily sales activity or the auditor's estimates of same. Indeed, the Division's offers to perform another observation test were declined by the corporation's representative. It is clear that the auditor's estimate of taxable sales for each day of the week was based upon the information available to her at the time. With respect to Mr. Silverman's analysis of the diner's average daily and weekly sales and the relationship of the amount of average taxable sales from one day of the week to the others, it was based upon records supplied by the corporation. Those records consisted of allegedly all of the guest checks and cash register tapes for various dates. Given petitioners' admission in their brief that they significantly underreported taxable sales during the audit period, I do not find either the source documents used by Mr. Silverman in his analysis or his analysis to be reliable. As for Mr. Paloubis's and George Rekkas's testimony concerning the diner's daily sales activity, I found their testimony on this point to be vague and unreliable.

Petitioners argue that the August 10, 2001 observation test results were atypical and the January 23, 2004 observation test results more accurately reflect the diner's sales activity on Fridays. Therefore, they claim the results of the January 23, 2004 observation test should be used to recompute the corporation's taxable sales for the period at issue. Petitioners' argument is rejected. In Conclusion of Law "E," I found that petitioners failed to prove by clear and convincing evidence that the observation test conducted on August 10, 2001 was flawed. As noted above, the corporation's representative declined the Division's offers to perform another observation test during the audit. The corporation must bear the consequences of that decision. As for the January 23, 2004 observation test, it was conducted outside of the diner for less than 24 hours and the auditor relied in part on an analysis of the guest checks and the cash register tape for that day supplied to her by Mr. Silverman. Given the time constraints that the auditor in that subsequent audit was working under and the questionable reliability of the corporation's source documents, I do not believe the results from that observation test more accurately reflect the diner's sales activity on Fridays. Petitioners have failed to prove by clear and convincing evidence that the amount assessed is erroneous (***Matter of Surface Line Operators Fraternal Org. v. Tully, supra***). Any imprecision in the audit results is the direct result of the corporation's failure to keep and maintain records of all its sales as required by Tax Law § 1135(a)(1) (***Matter of Markowitz v. State Tax Commission, supra***).

J. Since Cronos's books and records were inadequate, the Division was required to select an audit method reasonably calculated to reflect the taxes due, and upon their challenge to the assessments petitioners bore the burden to establish by clear and convincing evidence that the method of audit or the amount of tax assessed was erroneous (***Matter of Surface Line Operators Fraternal Org. v. Tully, supra***). Petitioners have failed to sustain their burden of proving that either the audit methodology or the amount of tax assessed was erroneous.

K. Penalties were imposed pursuant to Tax Law § 1145(a)(1)(i) which authorizes the imposition of penalties for failure to pay any tax imposed under Articles 28 and 29 of the Tax Law. Tax Law § 1145(a)(1)(iii) provides that if the failure or delay was due to reasonable cause and not due to willful neglect, penalty and additional interest shall be remitted. Reasonable cause includes any cause for delinquency which would appear to a person of ordinary prudence and intelligence as reasonable cause for the delay in filing a sales tax return and paying the tax imposed under Articles 28 and 29 of the Tax Law (20 NYCRR 536.5[c][5]). In this case, penalties were properly imposed because of the substantial discrepancy between the amount of reported taxable sales and the amount of tax determined on audit (***see, Matter of S.B.H. Super***

Markets v. Chu, 135 AD2d 1048, 522 NYS2d 985; ***Matter of Himed Deli Corp***., Tax Appeals Tribunal, March 20, 2000).

Petitioners have also been assessed penalty pursuant to Tax Law § 1145(a)(1)(vi) for omission of greater than 25 percent of the tax due. Since the initial issue of penalties assessed pursuant to Tax Law § 1145(a)(1)(i) has been determined against petitioners, this additional penalty must also be sustained in the absence of a showing of reasonable cause.

L. The petitions of Cronos Enterprises, Inc., Steven Paloubis, George Rekkas and Lambros Rekkas are denied and the notices of determination dated February 25, 2002 are sustained.

DATED: Troy, New York
March 10, 2005

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE