

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>HUI WANG D/B/A CHINATOWN CUISINE</b>	:	<b>DETERMINATION</b>
	:	<b>DTA NO. 820546</b>
for Revision of a Determination or Refund of Sales and	:	
Use Taxes under Articles 28 & 29 of the Tax Law for the	:	
Period June 1, 2000 through February 28, 2003.	:	

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Petitioner, Hui Wang d/b/a Chinatown Cuisine,<sup>1</sup> 739 Delaware Road, Buffalo, NY 14223-1231, 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, 2000 through February 28, 2003.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 130 East Main Street, Rochester, New York, on February 8, 2006 at 10:30 A.M., with all briefs submitted by April 21, 2006, which date began the six-month period for the issuance of this determination. Petitioner appeared by Ronald D. Anton, Esq. The Division of Taxation appeared by Mark F. Volk, Esq. (James Della Porta, Esq., of counsel).

***ISSUE***

I. Whether the Division of Taxation properly resorted to an estimated audit methodology, an observation test, to determine the amount of sales and use taxes due from petitioner during the audit period.

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<sup>1</sup>The Division of Taxation issued a Notice and Demand for Payment of Sales and Use Taxes due on February 13, 2004. It is noted that Tax Law § 173-a, effective and applicable to all notices issued after December 1, 2004, denied a taxpayer's right to petition for a hearing pursuant to a notice and demand where the tax had been finally determined to be due. Since the notice and demand issued in this case was issued on February 13, 2004, the provisions of Tax Law § 173-a are not applicable and petitioner's right to petition herein is not affected.

II. Whether the Division of Taxation's imposition of penalty and additional interest was proper.

***FINDINGS OF FACT***

1. During the period June 1, 2000 through February 28, 2003 (the "audit period"), Hui Wang d/b/a Chinatown Cuisine, (hereinafter "Petitioner"), operated a Chinese restaurant which was located within a strip plaza at 739 Delaware Road in Buffalo, New York. The business operated primarily on a take-out basis, with a small seating area for eat-in customers. Besides petitioner, two people were employed as a cook and washer. Petitioner's husband and children helped out as well from time to time.

2. The Division of Taxation began a field audit of petitioner on April 24, 2003 with the issuance of an appointment letter in which it requested a visit to the business location and the production of records including sales tax returns, federal income tax returns, New York State Corporation Tax Returns, the general ledger, sales invoices, exemption documents, bank statements, canceled checks, the cash receipts journal, the cash disbursements journal, expense purchase invoices and the merchandise purchase journal for the audit period. An additional written request for records was made by letter dated November 4, 2003 in which the Division requested cash register tapes and/or any detailed sales records for the entire audit period.

3. In response to the April 24, 2003 request for records, petitioner submitted very few documents. Although federal tax returns, resident income tax returns, some third-party information and handwritten monthly sales summaries were submitted, the Division was not provided with cash register receipts, bank statements, checks, or any other back-up documentation to sales tax returns. Due to the lack of records, the Division determined that it needed to resort to an indirect audit methodology to determine petitioner's sales tax liability.

4. Before the audit was commenced, the Division performed an outside observation of petitioner's restaurant on February 28, 2002, a Thursday. It noted that the business was located in a busy location in a strip plaza and did mostly a take-out business. Using the menu and counting the number of customers, 142, it was concluded that the restaurant was making about \$831.00<sup>2</sup> in sales on a daily basis and was substantially underreporting its tax liability. Based on this raw estimate, the Division decided to audit the business.

5. The Division contacted various third party suppliers but were unable to get complete records for all but one of them, Will Poultry, for the entire audit period. One of the suppliers, Poultry Products, produced documentation to the Division that indicated sales to petitioner \$2,800.00 higher than petitioner's invoices. In addition, investigation by the Division discovered that petitioner maintained cash accounts with vendors which could not be documented with a paper trail. Therefore, the Division concluded that these deficiencies jeopardized the credibility of petitioner's records to such an extent that a mark-up audit methodology was not possible and that an observation of the business would provide a more accurate estimation of petitioner's sales and tax liability.

6. By letter, dated September 8, 2003, the Division informed petitioner that the insufficiency of the documentation produced mandated that an indirect audit methodology would be employed to determine the sales tax due for the audit period, specifically an observation of the business for one entire business day, September 18, 2003, a Thursday.

7. Three Division employees observed the business for the entire day, from opening at 11:00 A.M. to closing at 10:00 P.M. They requested that the register be set to record the sales for the day and that a tape be supplied to document the register sales. The Division did not

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<sup>2</sup>Petitioner's sales journal indicated \$546.00 in total sales for February 28, 2002.

record the actual food ordered and petitioner's records never reflected itemized menu selections. The Division's employees also noted each sale during the day and, at the end of the observation, their total was \$1,070.80, \$0.96 less than the register tape, or \$989.19 after backing out sales tax. The Division's test reflected 93 customers for the day, 49 less than accounted for in the February 28, 2002 observation.

8. Using their observed sales figure of \$989.19, the Division multiplied by seven days, open each week to calculate weekly sales then by 13 to arrive at total quarterly sales of \$90,016.29. In order to account for inflation over the span of the audit period, the auditor decreased the quarterly sales figures by 2.8% for the quarters in 2000; 1.6% for the quarters in 2001; and by 2.2% for the quarters in 2003. These percentages were taken from the consumer price index as published by the Federal Reserve Bank and a blended rate was used for those quarters which included two calendar years.<sup>3</sup> After allowing for the tax paid with the sales tax returns, this yielded total additional sales and use taxes due for the audit period of \$46,724.92. The following table summarizes the aforementioned information.

Period Ended	Avg. Sales	Tax (8%)	Tax Paid	Tax Due
8/31/2000	84,330.25	6,746.42	2,524.00	4,222.42
11/30/2000	84,330.25	6,746.42	2,350.00	4,396.42
2/28/2001	85,904.42	6,872.35	2,533.00	4,339.35
5/31/2001	86,691.50	6,935.32	2,516.00	4,419.32
8/31/2001	86,691.50	6,935.32	2,528.00	4,407.32
11/30/2001	86,691.50	6,935.32	2,561.00	4,374.32

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<sup>3</sup>Although petitioner submitted menus she alleged represented each year in the audit period, they had no cover pages with identifying information and hours of operation, and it could not be discerned what price increments were from year to year. Since there were no records of what items were sold, even if the increase was known it would be impossible to assign a value to the increases. The menus also omitted specials and lunches which were included on the two sample menus submitted by the Division.

2/28/2002	87,616.21	7,009.30	2,575.00	4,434.30
5/31/2002	88,078.56	7,046.28	2,714.00	4,332.28
8/31/2002	88,078.56	7,046.28	3,319.00	3,727.28
11/30/2002	88,078.56	7,046.28	3,083.00	3,963.28
2/28/2003	89,370.38	7,149.63	3,041.00	4,108.63
<b>Total</b>				<b>\$46,724.92</b>

9. The Division assessed penalty for petitioner's failure to pay the tax determined to be due and owing for the periods in issue, which was determined to be underreported an average of 60.69% over the audit period.

10. The Division issued to petitioner a Notice and Demand for Payment of Tax Due, dated February 13, 2004, which set forth additional tax due of \$46,724.92, penalty of \$13,297.34 and interest of \$15,987.76, for a total of \$76,010.02 for the audit period.

11. At conference in the Bureau of Conciliation and Mediation Services, the total additional tax due was reduced to \$45,799.79 after an adjustment for 12 days when the business was closed for power outages and holidays, yielding a reduction of \$11,564.33 in sales for the audit period. It is this modified tax, together with the diminished penalty and interest, that remains in dispute.

12. Petitioner admitted having a background in the operation of restaurants before opening China Cuisine, but no formal education in the industry. Her bookkeeping at Chinatown Cuisine consisted of opening the cash drawer each day with \$50.00 and then depositing all receipts from sales into the cash drawer during the day, along with any invoices for deliveries of supplies. At the end of a business day petitioner added the cash and the receipts for inventory, subtracted the \$50.00 seed money and recorded the result as the daily sales total. Petitioner then transmitted these summary totals to her tax preparer, JFT Tax Service, Inc., at the end of each

quarter in a telephone call. JFT would prepare the sales tax returns for her signature based on the figures she supplied them. Petitioner became acquainted with JFT through a Chinese newspaper advertisement. She never received any counsel with respect to record-keeping from JFT.

13. Petitioner kept a sheet of paper for each month of the audit period with the daily sales totals recorded for each day of the month. Although her recollection was that Thursdays generally generated more revenue than other days of the week, her summary sheets did not substantiate this claim. In fact, after reviewing the daily sales sheets, the auditor concluded that seventy to eighty percent of the time Thursdays had lower sales than Fridays or Saturdays.

14. During the audit period, the restaurant had a cash register with the capability to record daily sales on a tape, but petitioner did not use it for that purpose on a consistent basis and could not produce tapes to substantiate daily sales. Instead, the methodology referred to above was employed, recording cash totals by hand to a sheet of paper. Petitioner did not maintain guest checks with a detailed description of menu items sold, thereby making it impossible to accurately account for actual quantities of a specific food items.

15. On the day of the observation test, petitioner claimed the restaurant was exceptionally busy, running out of chicken and rice. In general, petitioner believed that business was slower in June, July, August and September, while business was brisk in October, November and December. However, petitioner's own tax payments remitted with her returns indicated that sales were greater in the quarter ended August 31<sup>st</sup> than in the quarter ended November 30<sup>th</sup> for two out of the three years in the audit period (2000 and 2002) and almost equal in 2001.

### **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 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. Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

C. In this matter, the Division made a proper request for petitioner's books and records which only resulted in the production of tax returns, a handwritten sales journal and some purchase invoices. Petitioner was unable to produce source documentation of sales made during the audit period like cash register tapes, guest checks, an accurate purchase journal or bank records. A survey of petitioner's suppliers revealed that only one, Will Poultry, had complete records of petitioner's purchases for the entire audit period, while another, Poultry Products, indicated \$2,800.00 more purchases than petitioner stated. Most suppliers did not maintain records because petitioner paid for supplies in cash.

Due to petitioner's insufficient records and poor record-keeping, the Division found it impossible to verify taxable sales through a complete audit which could have determined the exact amount of tax due. In addition, the survey of suppliers proved equally fruitless due to a lack of information on petitioner's purchases, in part because of petitioner's cash-based



purchases. Additionally, the large discrepancy in the purchases made from Poultry Products demonstrated the lack of reliability of those records for purposes of an audit. Thus, the Division was justified in resorting to an estimated audit methodology, i.e., the observation test.

The one-day observation test performed by the Division to determine petitioner's taxable sales for the audit period was a methodology well-suited to the circumstances herein, where petitioner maintained no source documentation of her sales other than the hand-written summary sheets' and is supported by a large body of case law. (*See, e.g., Matter of Lombard v. Commr. of Taxation & Fin.*, 197 AD2d 799, 602 NYS2d 972 [one-day observation test]; *Matter of Vebol Edibles v. Tax Appeals Tribunal*, 162 AD2d 765, 557 NYS2d 678, *lv denied* 77 NY2d 803, 567 NYS2d 643 [two-day observation test]; *Matter of Club Marakesh v. State Tax Commn.*, 151 AD2d 908, 542 NYS2d 881, *lv denied* 74 NY2d 616, 550 NYS2d 276 [one-day observation test].)

Neither the handwritten sales journal nor petitioner's testimony rose to a level of clear and convincing evidence sufficient to show that the assessment was erroneous or that the audit methodology was unreasonable. (*See Matter of Scarpulla v. State Tax Commn., supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra.*) The problem is that there is no reason to believe that the data in the handwritten sales journal is sufficiently accurate to establish that the observation test reached an erroneous result. Had petitioner been able to demonstrate through source documentation that her sales journal was more accurate than the Division's estimate generated by the observation test, then her argument might have had more credibility. But her inadequate and otherwise nonexistent records gave the Division the authority to use a method, which, although less than precise, was reasonably calculated to reflect the taxes due, and

nothing she produced or said clearly or convincingly challenged the audit methodology or the amount of tax determined to be due.

D. Further undermining petitioner's attack on the accuracy of the observation test was the conflict between her testimony that sales in the quarter ended August 31 were less than sales in the quarter ended November 30 and her tax returns for those periods which indicated just the opposite. The same conflict arose between her testimony that Thursdays were her busiest day of the week and her own handwritten sales journal, which indicated that for the majority of weeks in the audit period this was not the case.

E. Finally, the Division's first observation of the business prior to the audit on February 28, 2002, albeit a raw estimate of sales without the detail of the September 18, 2003 observation test, estimated total sales of \$831.00 for 142 customers, while petitioner's sales journal indicated \$546.00. The Division's figure was only \$138.00 less than the detailed observation of September 18, 2003, while petitioner's sales journal reflected a sales total of \$443.00 less. In the latter observation test, the Division noted 93 customers who accounted for \$989.00 in sales. The reasonable conclusion that can be drawn from these facts is that petitioner's handwritten sales journal substantially understated the actual sales.

To demonstrate this point, a rough yet startling computation highlights the deficiencies in petitioner's sales journal. A simple division of the sales per petitioner's journal by the number of customers (142) calculated for the February 2002 observation test, yields an average sale per customer of \$3.85. The same calculation for September 18, 2003 reflects an average sale of \$10.63. Since there is no dispute concerning the sales made in September 2003 or the number of customers, the question arises whether the average sale could have been almost \$7.00 less in February 2002. It is more likely that petitioner's recorded sales were understated, and without

any other source documentation, the handwritten sales journal lacks credibility and cannot provide a basis for determining petitioner's tax liability for the audit period.

F. Although petitioner did not directly challenge the prices used to estimate sales during the audit period, petitioner submitted menus for the years 2000, 2001, 2002 and 2003 which indicated price increases for various items. However, the menus were devoid of cover pages with identifying information and failed to contain pages with special dishes and lunch specials, which appeared in the menus submitted by the Division. The Division allowed for the increases in menu items for each year in the audit period as mentioned in the facts, using the Federal Reserve Bank's published figures for inflation. The auditor decreased the quarterly sales figures by 2.8% for the quarters in 2000; 1.6% for the quarters in 2001; and by 2.2% for the quarters in 2003 in order to reach reasonable estimates of sales for each year. Again, petitioner's failure to document accurate prices and specify quantities of menu items sold precludes a conclusion that the Division's estimate was not reasonably calculated to reflect the taxes due.

G. Having concluded that the Division properly utilized an estimated audit methodology and that petitioner was unable to demonstrate that the results were erroneous, it must be determined if petitioner has established reasonable cause to abate the penalties imposed. Tax Law § 1145(a)(1)(I) provides for penalty to be imposed where a person fails to pay over any tax within the time required by law. The Division assessed penalty against petitioner under this section.

Tax Law § 1145(a)(1)(iii) and 20 NYCRR 2392.1(a)(1) provide that the Division can remit the penalty if the failure to pay over the tax was due to reasonable cause. Petitioner claims that she has demonstrated reasonable cause herein based upon her handwritten sales journal and her testimony, which she says calls into question the Division's chosen methodology and the

results therefrom. Further, petitioner contends that she never intended to violate the law and had no knowledge of the law or regulations regarding the maintenance of records.

Unfortunately, petitioner's testimony, the credibility of which was severely diminished by conflicting information in petitioner's sales journal and tax returns, was not sufficient to show the Division's observation test or estimate unreasonable. In fact, the Division's careful testing and adjustments appeared more accurate than petitioner's record keeping. And arguments that one was unaware of record-keeping requirements and other provisions of the Tax Law and regulations amounts to nothing more than a defense of ignorance, which does not rise to the level of reasonable cause. (*Genesee Brewing Co. v. Village of Sodus Point*, 126 Misc 2d 827, 482 NYS2d 693, 700, *affd* 115 AD2d 313, 496 NYS2d 720; *accord, Matter of Nathel v. Commr. of Taxation and Fin.*, 232 AD2d 836, 649 NYS2d 196 [wherein it was held that ignorance of the law is not excuse and that a taxpayer is charged with knowledge of the law, including subsequent judicial interpretation of thereof].)

In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). Referring to the mandatory language of Tax Law § 1145(a)(1)(I), the Tribunal said that "the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation." (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992). In the instant matter, petitioner neither maintained nor produced records as required, and those she did keep were without any source documentation due to her failure to use a register tape in the cash register or issue guest checks for each sale. In addition, there was a substantial discrepancy between reported sales and audited sales as

evidenced by the tax paid with her returns during the audit period and the tax found due as a result of the audit. For all of these reasons penalties must be sustained.

H. The petition of Hui Wang d/b/a Chinatown Cuisine is denied and the Notice and Demand for Payment of Tax Due, dated March 5, 2004, is sustained.

DATED: Troy, New York  
October 23, 2006

/s/ Joseph W. Pinto, Jr.  
ADMINISTRATIVE LAW JUDGE