STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions of **WILD GINGER, LLC d/b/a KOO AND ALEX POON OFFICER OF WILD GINGER, LLC d/b/a KOO** for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 2003 through November 30, 2005.	:	DETERMINATION DTA NOS. 821633 AND 821634

Petitioners, Wild Ginger, LLC d/b/a KOO and Alex Poon, officer of Wild Ginger, LLC d/b/a KOO, 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 June 1, 2003 through November 30, 2005.

A consolidated 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 November 20, 2007 with all briefs to be filed by March 20, 2008. Petitioners appeared by S. Buxbaum and Company, CPA's, LLP (Michael Buxbaum, CPA). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne Jack, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined that petitioner Wild Ginger, LLC d/b/a KOO underreported sales taxes.

II. Whether the Division of Taxation met its burden of proving fraud.

III. Whether the Division of Taxation's assertion of alternative penalties, in the event that the fraud penalty is not sustained, was proper.

FINDINGS OF FACT

1. Petitioner Wild Ginger, LLC d/b/a KOO (restaurant) was a restaurant which sold a variety of Asian foods, such as Japanese and Chinese cuisine, in Rye, New York. It had a

seating capacity of about 100 patrons. Petitioner Alex Poon was the sole owner of the restaurant.

2. On August 9, 2005, the Division of Taxation (Division) sent an appointment letter to the restaurant stating that its sales and use tax returns had been scheduled for a field audit for the period December 1, 2001 through May 31, 2005.[1] The letter provided that "[a]ll books and records pertaining to the sales and use tax liability, for the audit period, must be available on the appointment date." A schedule of books and records to be produced was attached to the letter.

3. The Division did not receive a response to its first appointment letter. On August 25, 2005, it sent a second appointment letter.

4. After the second request was sent, the Division received a telephone call from an accountant named Keith Wofsey to schedule an appointment. Approximately two weeks later Mr. Wofsey called the auditor assigned to this matter to say that the restaurant was filing a petition for bankruptcy and therefore did not need to provide the books and records. The auditor then spoke to her supervisor who said that the audit had to continue despite the filing for bankruptcy.

5. In December 2005 the Division's auditor met with Mr. Wofsey at the restaurant. At this time, Mr. Wofsey provided weekly sales summaries showing sales for five months in 2004 and five months in 2005.[2] Mr. Wofsey did not provide any backup to the summary sheets and stated that he did not have any other records.

6. After reviewing the papers provided by Mr. Wofsey, the Division considered referring the matter for criminal prosecution because the documents showed average quarterly sales of about $300,000.00, while the restaurant was reporting about $10,000.00 of taxable and gross

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[1] The original audit period was changed because petitioners produced records showing that the business was started in June of 2003. Accordingly, the revised audit period was June 1, 2003 through November 30, 2005.

[2] The document was incorrectly labeled "daily."

sales during the same period of time. In addition, the Division's analysis of the records showed that more than $300,000.00 in tax was due.

7. Mr. Poon became disenchanted with Mr. Wofsey's representation. Mr. Poon discharged Mr. Wofsey and retained Amy Shen, CPA, to represent him and the restaurant on the audit.

8. When Mr. Poon hired Ms. Shen, she called Keith Wofsey, but he refused to take her call. Ms. Shen then directed Mr. Poon to drive to Mr. Wofsey's office in Connecticut and demand that he turn over petitioners' records. Thereafter, Mr. Poon obtained the records and delivered them to Ms. Shen.

9. Upon receiving the records, Ms. Shen instructed two of her assistants to place all of the information onto a spreadsheet. When this was completed, Ms. Shen called the Division in order to present the information. Mr. Poon instructed Ms. Shen to present to the Division all of the information that she had. He also told her to file complete and accurate returns.

10. On February 2, 2006, the Division met with Ms. Shen, Mr. Ma, who was Mr. Poon's friend, and Mr. Poon. At this meeting, Ms. Shen provided cash register tapes and a summary of sales tax collected for the period December 1, 2003 through November 30, 2005. After making a comparison, the Division determined that the amounts on the cash register tapes were correctly transcribed onto the summary sheets. Although requested to do so by the Division, Ms. Shen did not provide any records for the period June 1, 2003 through November 30, 2003 because she did not have cash register tapes for this period. The Division was also presented with bank statements which were deemed inadequate because there were missing statements and there was an invalid account number and an account closure. When she offered the records, Ms. Shen did not provide an explanation of why the records were not presented earlier. After the meeting, the auditor's supervisor considered Ms. Shen to be cooperative.

11. On February 3, 2006, the Division's representatives met again with Mr. Ma, Mr. Poon and Ms. Shen. Income Tax Team Leader George Ranney was also present because the Division's records showed the filing of withholding tax returns for only three quarters during the audit period. During this meeting, Mr. Poon stated that the restaurant's manager, Ms. Yu Wen Hsieh, conducted all business transactions for the restaurant for the period June 1, 2003 through September 30, 2004. Mr. Poon also stated that his weekly income was $1,000.00, although the business records showed that he had a salary of $150,000.00 a year. Mr. Poon also stated that he paid his prior accountant $1,400.00 each month to pay payroll tax for his employees that was never remitted to New York State. The Division responded that he should provide evidence in the form of checks to support this assertion.

12. The Division conducted an observation test of the restaurant on February 23, 2006. The observation confirmed to the Division that all of the sales were entered into the cash register. After the observation test, the Division deemed the records provided to be adequate for the period of time that they covered, i.e., December 1, 2003 through November 30, 2005.

13. The Division decided to base the assessment on the records presented. For the months of June 2003 through November 2003, the five months that records were not available, the Division decided that it would project the sales from the records that were presented.

14. The restaurant's records showed that it had food and beverage sales of $2,387,837.00 for the period December 1, 2003 through November 30, 2005. From this amount, the Division determined that the restaurant had average food and beverage sales of $99,413.18 for the months of July through November 2003. The Division then added the restaurant's sales throughout the audit period to determine that the total food and beverage sales during the audit period were $2,885,302.17.

15. The restaurant also provided records of the service charges that appeared on credit card slips for the period December 1, 2003 through November 30, 2005.By calculating an average service charge and then attributing that amount to the months where records were

unavailable, as it had for food and beverage sales, the Division calculated an average monthly service charge of $14,608.94 for the months of July through November 2003 resulting in total service charges of $423,659.31 for the period in issue. Since petitioners did not prove to the Division's satisfaction that the service charges which appeared on the credit slips were paid to the restaurant's employees, the Division considered the service charges to be fully taxable.[3]

16. The Division also determined that additional tax was due of $1,837.47 on fixed asset purchases. This amount is not in issue.

17. Following an audit of the restaurant's tax accrual account, the Division determined that the restaurant collected $165,346.74 in taxes over the period December 1, 2003 through November 30, 2005, but remitted only $16,587.00 on its returns. After allowing a credit for the $16,587.26 the restaurant reported and paid in sales tax, the Division determined that the additional tax due from sales was $224,745.11 and that the additional tax due on the audit was $226,582.58.

18. The discrepancy between the amount of tax reported and the sales tax determined to be due during the audit period was as follows:

Sales Tax Quarter	***Sales Tax Reported***	***Sales Tax Found Due***
08/31/03	$801.28	$17,010.48
11/30/03	805.29	23,156.17
02/29/04	sales tax not reported	22,858.50
05/31/04	sales tax not reported	26,775.17
08/31/04	828.75	27,139.78
11/30/03	829.20	24,716.33
02/28/05	825.53	20,559.00
05/31/05	833.18	24,859.35

[3] This portion of the assessment does not pertain to service charges which were paid by cash.

08/31/05	sales tax not reported	27,942.67
11/30/05	11,664.00	26,545.79

19. On the basis of the forgoing audit, the Division issued a Notice of Determination, dated May 1, 2006, to Wild Ginger, LLC d/b/a KOO, which assessed tax in the amount of $226,582.58, plus interest in the amount of $54,215.88 and penalties in the amount of $163,057.56 for a balance due of $443,856.02. On the same day, the Division issued a Notice of Determination to Alex Poon as an officer or responsible person of Wild Ginger, LLC d/b/a KOO. The notice issued to Alex Poon assessed the same amount of tax, penalty and interest as was assessed against the restaurant. On each notice, omnibus penalties and fraud penalties were imposed pursuant to Tax Law § (a)(1)(vi) and § 1145(a)(2). The omnibus penalties were assessed because the restaurant underreported tax in excess of 25 percent of the amount that should have been reported.

20. Civil fraud penalties were assessed because, in the beginning, petitioners failed to provide the restaurant's books and records. The Division also believed that petitioners filed for bankruptcy to avoid payment of the tax. The Division further noted that the restaurant did not withhold income tax from its employees. In addition, the Division observed that for the sales tax quarter after the Division scheduled an audit appointment, the sales reported by the restaurant were approximately $155,000.00, as opposed to approximately $11,000.00 for each of the prior quarters.

21. Alex Poon was born in China. He began working at the age of 10 and did not complete high school.

22. The restaurant's manager, Yu Wen Hsieh, handled the operations of the business. The restaurant's former accountant, Keith Wofsey, was responsible for the financial affairs of the business. Mr. Wofsey handled the books, tax returns and, although he did not have express authority to do so, signed checks. Mr. Wofsey also signed the sales tax returns throughout the audit period. Mr. Wofsey was not a certified public accountant.

23. Mr. Poon filed for bankruptcy in 2005 because it was recommended by his attorney. The attorney told Mr. Poon that it would solve his problems.

24. During the period in issue, the restaurant had six to eight employees. Ms. Yu Wen Hsieh was in charge of paying the employee's wages and responsible for withholding taxes from the wages of the employees. She is no longer employed by the restaurant because Mr. Poon believes that she inappropriately took money from the restaurant.

25. Currently, Ms. Shen's office prepares the sales tax returns on the basis of daily sales records.

26. All of the restaurant's credit card charges were deposited directly into the restaurant's bank account. There is no record that the employees received any portion of these amounts.

27. According to industry practice, tips paid by credit card are placed in the bank account. Thereafter, they are withdrawn as cash and paid to the employees as wages and tips.

SUMMARY OF THE PARTIES' POSITIONS

28. At the hearing, Mr. Poon stated that he visited the restaurant a couple of times per week. When he was there, he stayed for a few hours and only helped cook. When he was not at the restaurant, Mr. Poon took care of his son, who is in school. Mr. Poon brought his son to school and picked him up nearly every day. Mr. Poon also stated that he was disappointed when he learned during the audit that Mr. Wofsey had not prepared certain sales tax returns, income tax returns and payroll tax returns.

29. Mr. Poon is not trained in accounting and stated that he did not know if Mr. Wofsey was paying the proper amount of taxes. Although he did not have express authority to do so, Mr. Wofsey made a practice of signing checks drawn on the restaurant's account. At the hearing, Mr. Poon explained that during the period in issue he was unaware that Mr. Wofsey was not a certified public accountant. According to Mr. Poon, he did not have certain records requested by the Division because when Ms. Yu Wen Hsieh left the restaurant, she took the restaurant's records with her.

30. Mr. Poon believes that his current accountant, Ms. Shen, files correct sales tax returns, income tax returns and payroll tax returns. Ms. Shen tells Mr. Poon when to pay taxes.

31. In their brief, petitioners maintain that the Division should not have imposed tax on the service charges and that penalties should be cancelled.

32. The Division contended that the service charges were taxable receipts. If the fraud penalty were not sustained, it asserted, in the alternative, imposition of interest and penalties under Tax Law §§ 1145(a)(1) and (2).

CONCLUSIONS OF LAW

A. The first issue presented is whether it was proper for the Division to consider the service charges that were paid by credit card as sales by the restaurant.[4] Tax Law § 1105(d)(I) imposes sales tax upon "receipts . . . from every sale of food and drink of any nature . . . including in the amount of such receipts any cover, minimum . . . or other charge made to patrons or customers. . . ." Tax Law § 1101(b)(3) defines receipts as "[t]he amount of the sale price of any property and the charge for any service taxable under this article . . . without any deduction for expenses. . . ." The service charge billed to customers is taxable as a receipt from the sale of food or drink unless: "(1) the charge is separately stated on the bill or invoice given to the customer; (2) the charge is specifically designated as a gratuity; and (3) all such monies received are paid over in total to employees." (20 NYCRR 527.8[l].)

B. Here, there is no evidence that the service charges which the patrons paid by credit card were paid to the employees. In this regard, Ms. Shen's testimony regarding industry practice of paying employees cash after the money is collected by the restaurant is of very limited value since she was not employed by the restaurant during the audit period. Therefore, she was not in a position to know whether the restaurant was following industry practice during

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[4] It is noted that petitioners have not challenged the use of the indirect audit methodology to determine the amount of tax due for those months where no records were available. An indirect audit methodology is appropriate when, as here, the taxpayer's records are inadequate to conduct an audit for a portion of the audit period (***see Matter of Ianiello v. Tax Appeals Tribunal***, 209 AD2d 740 [1994]).

the period in issue. In view of the lack of evidence that the restaurant was paying the service charges to the employees, the Division properly treated the service charges in issue as additional restaurant receipts.

C. The issue which remains is whether petitioners are liable for the fraud penalty. Tax Law § 1145(a)(2) provides, in pertinent part, as follows:

> If the failure to pay or pay over any tax to the commissioner of taxation and finance within the time required by this article is due to fraud, in lieu of the penalties and interest provided for in subparagraphs (i) and (ii) of paragraph one of this subdivision, there shall be added to the tax (i) a penalty of fifty percent of the amount of the tax due, plus (ii) interest on such unpaid tax. . . .

D. Citing ***Matter of Drebin v. Tax Appeals Tribunal*** (249 AD2d 716 [1998]), the Tax Appeals Tribunal concluded in ***Matter of What a Difference Cleaning, Inc.*** (Tax Appeals Tribunal, May 15, 2008) that the issue of whether a taxpayer wilfully failed to file returns and timely pay tax with the intent to evade payment of tax presents a question of fact to be determined upon consideration of the entire record. In order to support a finding of fraud, the Division is required to show by clear and convincing evidence "clear, definite, and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing" (***see Matter of What a Difference Cleaning, Inc.***). In order for the Division to establish fraudulent intent, it must prove that petitioners acted deliberately, knowingly and with the specific intent to violate the Tax Law (***see Matter of Cousins Serv. Sta.***, Tax Appeals Tribunal, August 11, 1988).

E. In ***Matter of What a Difference Cleaning***, the Tax Appeals Tribunal set forth the following considerations with respect to finding fraudulent intent:

> The sales tax penalty provisions are modeled after Federal penalty provisions and, thus, Federal statutes and case law may properly provide guidance in ascertaining whether the requisite intent for fraud has been established (***see***, ***Matter of Uncle Jim's Donut & Dairy Store,*** Tax Appeals Tribunal, October 5, 1989). Since direct proof of a taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, including the taxpayer's course of conduct (***Intersimone v. Commissioner***, T.C. Memo 1987-290, 53 TCM 1073 [1987]; ***Korecky v. Commissioner,*** 781 F2d 1566 [1986], 86-1 USTC ¶ 9232). Relevant factors held

> to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, the existence of a pattern of repeated deficiencies and the taxpayer's entire course of conduct (***see, Merritt v. Commissioner***, 301 F2d 484 [1962], 62-1 USTC ¶ 9408; ***Bradbury v. Commissioner***, T.C. Memo 1996-182, 71 TCM 2775 [1996]; ***Webb v. Commissioner***, 394 F2d 366 [1968], 68-1 USTC ¶ 9341; ***see also, Matter of AAA Sign Co.***, Tax Appeals Tribunal, June 22, 1989).

F. In its brief, the Division has correctly noted that the record offers several indicia of fraud. The restaurant substantially underreported the amount of tax due. As pointed out by the Division, even if the service charges were not subject to tax, the amount of sales tax due would still be more than $195,000.00. The Division has also correctly pointed out that the underreporting was continuous throughout the audit period. Sales tax returns were not filed for three of the audit periods. For six of the remaining seven periods, the restaurant reported both gross and taxable sales of between $11,000.00 and $12,000.00 and tax due thereon of between $800.00 and $850.00 dollars. For the last sales tax quarter of the audit period, after the audit appointment letter was sent, the restaurant reported gross and taxable sales of $155,000.00 and taxes due of $11,664.00. The later amount was still $14,881.79 less than the amount of tax found due on the audit. No explanation has been offered for the sudden increase in reported sales and sales tax due.

G. There are also a number of factors which indicate a knowledge and intent to defraud the State. At the outset of the audit, petitioners declined to make many of their records available for review. At the first audit appointment, petitioners' representative only offered summary sheets without any of the cash register tapes or bank statements which were in their possession. Apparently, petitioners were unaware at the time that sales tax is governed by the "trust fund" provisions of the Bankruptcy Code and is not dischargeable in bankruptcy (***see Matter of Milne***, Tax Appeals Tribunal, February 17, 2005). On the basis of this misunderstanding, they attempted to prevent further disclosure by declaring bankruptcy. The lack of cooperation during the early stage of the audit is additional evidence of fraud (***Matter of Lefkowitz***, Tax Appeals

Tribunal, May 3, 1990). No credible explanation has been advanced for the failure to present, at the earliest opportunity, the records which were available.[5]

As noted by the Division, a clear indication of petitioners' intent to disregard the Tax Law can be discerned from the dramatic increase in reported sales and tax due after the notice scheduling the audit appointment was mailed. Petitioners have not offered any explanation for this increase.

Lastly, an indicium of fraud may be discerned from petitioners' practice of remitting a small percentage of the tax collected. The audit of the tax accrual account showed that the restaurant collected at least $165,346.74 in sales tax during the period December 1, 2003 through November 30, 2005 while it remitted only $16,587.00 to New York.

H. Petitioners' explanations for the lapses outlined above are unconvincing. At the hearing and in their briefs, petitioners blamed the failure to comply with the Tax Law upon their complete reliance on Mr. Wofsey to prepare the returns correctly. If one were to accept Mr. Poon's testimony, he was only at the restaurant a couple of times a week, and when he was there he occupied his time cooking. Bearing in mind that Mr. Poon was the sole owner of a restaurant which conducted a substantial business, this testimony is difficult to accept. It is hard to reconcile this testimony with the dramatic increase in reported sales after receiving notice that an audit was about to be conducted. Clearly, Mr. Poon was aware that there was a reporting difficulty. It is also difficult to accept Mr. Poon's explanation that he was not involved with his business because his time was consumed taking care of his son who was apparently in school during the day. In this regard, it noteworthy that petitioners did not call either Mr. Wofsey or Ms. Yu Wen Hsieh to substantiate Mr. Poon's version of the facts.

It is recognized that Mr. Poon had limited education and training in business matters. It is also understood that English is not Mr. Poon's native language. However, these limitations do

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[5] At the hearing Mr. Poon offered the questionable explanation that when Ms. Yu Wen Hsieh left the employment of the restaurant she took the restaurant's records with her including the cancelled checks.

not prevent an individual from understanding that money collected for paying sales tax was not remitted.

It is also recognized that there was more cooperation on petitioners' behalf after Ms. Shen became involved. Nevertheless, this cooperation is just one indicium and does not outweigh the strong conclusion that one must draw from the remaining indicia discussed above that the fraud penalty was properly assessed.

I. In view of the conclusion that the fraud penalty was properly asserted, consideration of the alternative penalties is academic and will not be discussed. Similarly, petitioners' request to cancel any of the penalties which were asserted in the alternative is also academic.

J. The petitions of Alex Poon, officer of Wild Ginger, LLC d/b/a KOO and Wild Ginger, LLC d/b/a KOO are denied and the notices of determination are sustained together with such penalties and interest as are lawfully due.

DATED: Troy, New York
September 18, 2008

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE