

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions	:	
of	:	
<b>NORTH COUNTRY CATERING, INC.</b>	:	DETERMINATION
<b>AND</b>	:	DTA NOS. 821814
<b>ST. JAMES COLONIAL DELI, INC.</b>	:	AND 821815
for Revision of Determinations or for Refund of	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 2003 through	:	
November 30, 2005.	:	

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Petitioners, North Country Catering, Inc., and St. James Colonial Deli, Inc., 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 Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York on February 28, 2008 at 10:30 A.M., with all briefs to be submitted by July 21, 2008, which date commenced the six-month period for issuance of this determination (Tax Law § 2010[3]).

Petitioners appeared by Isaac Sternheim & Co. (Isaac Sternheim, CPA). The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

***ISSUES***

I. Whether the audit methodology employed by the Division of Taxation, and the result derived therefrom that petitioner North Country Catering, Inc., owed additional sales tax, plus interest and penalties, was proper and should be sustained.

II. Whether petitioner St. James Colonial Deli, Inc., is liable as a bulk purchaser pursuant to Tax Law § 1141(c) for the sales tax determined to be due from petitioner North Country Catering, Inc.

III. Whether petitioner North Country Catering, Inc., has established any basis warranting reduction or elimination of the penalties imposed.

### ***FINDINGS OF FACT***

1. Prior to as well as during the period June 1, 2003 through October 1, 2005, petitioner North Country Catering, Inc. (North Country) operated a delicatessen in a 10 to 12 tenant strip mall shopping center located at 43010 North Country Road, St. James, New York. North Country's business was described as a medium sized delicatessen located on a busy road. There were no tables or chairs provided for patrons to dine in at the premises.

2. By a letter dated May 11, 2006, the Division of Taxation (Division) advised North Country that a sales tax field audit of its business operations for the period spanning June 1, 2003 through February 28, 2006 would commence on June 5, 2006. This audit appointment letter included a Records Requested List specifying that all of North Country's books and records pertaining to its sales and use tax liability for the audit period were required to be available for review, including cash receipts and disbursements journals, general ledgers, sales invoices, purchases invoices, cash register tapes, federal income tax returns, sales tax returns, bank statements, and canceled checks. The letter also advised that additional records and information might be required during the course of the audit.

3. On May 25, 2006, the Division received a Notification of Sale, Transfer or Assignment in Bulk (Form AU-196.10) advising that North Country was being sold to St. James Colonial

Deli, Inc. (St. James) This notification, hand-dated May 19, 2006 and signed by North Country's president, John Boyle, listed the scheduled date of sale as May 1, 2006.

4. The Division's auditor met with North Country's former representative on June 28, 2006, at which time the only records made available were some bank statements, sales tax returns with attached worksheets, and daybooks for a small portion of the audit period. The auditor was advised that North Country's taxable sales were calculated based upon daybooks. No cash register tapes, sales invoices or other detailed records of sales were available. The auditor advised North Country that the records provided were not sufficient for the conduct of a detailed audit based thereon, most specifically because such records were incomplete and because no sales records whatsoever were provided.

5. North Country had been audited twice before by the Division. In each of the prior audits, the Division's review of records revealed them to be, as here, incomplete and inadequate for purposes of conducting a detailed audit. As a consequence, in each of the prior audits the Division conducted an observation of North Country's sales and projected its tax liability based thereon. The second audit immediately preceded the audit at issue herein, covered the period September 1, 2000 through May 31, 2003, and resulted in an increase of approximately \$116,000.00 to North Country's reported taxable sales per sales tax quarterly period. The first audit immediately preceded the second audit, covered sales tax quarterly periods within the years 1998, 1999 and 2000 (the particular sales tax quarterly periods encompassed within the first audit period were not specified in the record). This audit resulted in an increase of approximately \$100,000.00 to North Country's reported taxable sales per sales tax quarterly period. North Country, through its representative at the time, agreed to the results of each audit.

6. North Country ceased operating its business on or about October 1, 2005, a fact confirmed by the auditor upon a brief visit to North Country's premises on May 22, 2006. In light of the lack of records upon which to conduct an audit for the period in issue, and since North Country was not in operation at the time of the subject audit, the auditor chose to utilize the results of the most recent prior audit (the second audit), and its determination of audited taxable sales, as the basis for computing taxable sales for the subject audit. Based on its December 6, 2000 full-day observation of North Country's sales, the Division determined audited taxable sales of \$1,274,242.00 for the audit period September 1, 2000 through May 31, 2003 (i.e., the second audit), or \$115,838.00 of audited taxable sales for each of the 11 sales tax quarterly periods encompassed within this audit period.<sup>1</sup>

7. On the current audit, the auditor multiplied the \$115,838.00 in quarterly taxable sales amount by the nine full sales tax quarterly periods encompassed within the portion of the audit period June 1, 2003 through August 31, 2005, and added to such resulting total \$38,613.00 ( $\$115,838.00 \div 3 = \$38,613.00$ ) for the one additional month of October 2005 during which North Country remained in operation during the audit period, to arrive at total audited taxable sales in the amount of \$1,081,155.00. The auditor reduced this amount by North Country's reported taxable sales of \$710,335.00, resulting in additional taxable sales of \$370,820.00 and additional sales tax due thereon in the amount of \$32,381.85.

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<sup>1</sup> Specifically, the result of the Division's December 6, 2000 observation of North Country's business revealed daily total gross sales of \$1,906.61, of which \$1,457.15 were taxable sales, leaving a taxable ratio of 76.43%. The daily gross sales amount (\$1,906.61) was multiplied by six days per week to arrive at weekly gross sales (\$11,439.66). This amount was in turn multiplied by 13 weeks to arrive at quarterly gross sales (\$148,715.58) for the year 2001. To account for inflation, this amount was reduced by three percent to arrive at quarterly gross sales for the year 2000 (\$144,254.11), and was increased in succession by three percent per year to arrive at quarterly gross sales for the years 2002 and 2003 (\$153,177.05 and \$157,638.51, respectively). Totaling quarterly gross sales from the foregoing calculations resulted in gross sales of \$1,6676,201.65 for the audit period which, after application of the 76.43% taxable ratio, resulted in audited taxable sales of \$1,274,242.23, or \$115,838.00 per quarter, as noted.

8. On August 10, 2006 the Division issued to petitioner North Country a Notice of Determination, based upon the foregoing audit calculations, assessing additional sales tax due in the amount of \$32,381.85, plus interest and penalties, including the omnibus penalty imposed pursuant to Tax Law § 1145(a)(1)(vi) premised upon the failure to report and pay an amount in excess of 25 percent of the amount of tax required to be shown on a return.

9. On August 11, 2006, the Division issued a Notice of Determination assessing tax due in the amount of \$32,381.85 against petitioner St. James, as the purchaser in bulk of North Country's business assets. At hearing, St. James conceded and does not dispute its derivative liability, as a bulk sale purchaser pursuant to Tax Law § 1141(c), for the tax owed by North Country.

10. At hearing, North Country provided cash register tapes pertaining to 15 of the 30 months covered by the audit period. Specifically, these tapes were for the months of June, July, August, September, October and November of 2003, and for the period spanning January through September of 2005. The cash register tapes provided by North Country showed summaries of gross sales for the days and months provided, but did not provide any details as to the individual items sold or identify taxable as opposed to nontaxable sales. No tapes were available for some 24 days during the noted 15 months for which tapes were provided.

#### ***SUMMARY OF PETITIONERS' POSITION***

11. North Country maintains, first, that the Division's use of the results of an observation test conducted on a prior audit is too far removed from the period here in question to be reliable, specifically because it fails to account for changes, including an alleged downturn, in North Country's business. In addition, North Country countered the Division's assessment with its own calculation resulting in additional tax due in the alternative amounts of either \$16,394.00 or

\$11,192.00. North Country's calculation method involved arriving at monthly gross sales for each of the 15 months for which cash register tapes were available.<sup>2</sup> The resulting 15-month gross sales total (\$618,028.00) was reduced by \$31,005.00, representing the average daily amount of sales tax paid multiplied by 30 days per month and by 15 months, resulting in net sales "per tapes" (\$587,023.00). North Country divided such net sales amount by the 456 days in the 15-month period for which tapes were provided to arrive at average sales per day (\$1,287.00), and multiplied such amount by the 913 days in the audit period to arrive at \$1,175,031.00 in total sales for the audit period. North Country first applied the 76.43% taxable ratio, as determined by the Division via its December 6, 2000 observation test, against such sales amount to calculate taxable sales (\$898,076.00). In turn, North Country reduced such amount by taxable sales reported (\$710,335.00), to arrive at additional taxable sales (\$187,741.00) and tax due thereon in the amount of \$16,394.00. Alternatively, North Country applied a lower taxable ratio of 71.36%, premised upon alleged errors made by the Division in its observation test, resulting in a lower taxable sales amount (\$838,502.00).<sup>3</sup> In turn, such amount was reduced by reported taxable sales (\$710,335.00), to arrive at additional taxable sales (\$128,167.00) and tax due thereon in the amount of \$11,192.00. North Country asserts that either of these two alternative amounts of tax (\$16,394.00 or \$11,192.00) more accurately reflects its business and its additional tax liability for the audit period.

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<sup>2</sup> An average daily gross sales amount was calculated and used with respect to the noted 24 days for which there were no cash register tapes out of the 15-month period for which cash register tapes were provided.

<sup>3</sup> Although not entirely clear from the record, the alleged errors appear to stem from differences between the amounts rung up on North Country's cash register on the day of the Division's observation versus the individual amounts and resulting totals as actually recorded by Division personnel during the course of conducting the observation.

12. North Country also requests that penalties be reduced or abated. In this regard, North Country's president noted that North Country's business declined due to changes in the number and type of tenants in its strip mall location and to competition from nearby businesses, including a pizza restaurant and a convenience store. He also stated that in the wake of the earlier audits, North Country had increased its estimated taxable sales percentage and believed that as a consequence North Country was reporting and paying the proper amount of sales tax due.

### ***CONCLUSIONS OF LAW***

A. The standard for reviewing a sales tax audit where an indirect audit methodology has been employed in the determination of sales tax liability is well established, and was set forth in *Matter of AGDN, Inc.* (Tax Appeals Tribunal, February 6, 1997), as follows:

[a] vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ' (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43). When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (*Matter of Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869); exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of*

***Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451).

B. In this case, the record establishes the Division's clear and unequivocal written request for books and records of North Country's sales, as well as North Country's failure to produce such books and records. The auditor reasonably concluded that North Country did not maintain or have available books and records that were sufficient to verify gross and taxable sales for the audit period including, most tellingly, any records of sales. Having established the unavailability of required books and records, the Division was clearly entitled to resort to the use of indirect audit methods to determine North Country's sales and sales tax liability. In fact, the Division's authority to do so has been consistently sustained (*see Matter of Del's Mini Deli, Inc. v. Commr of Taxation and Fin*, 205 AD2d 989 [1994]; *Matter of Vebale Edibles v. Tax Appeals Tribunal*, 162 AD2d 765 [1990]; *Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878, [1992]; *Matter of Marte*, Tax Appeals Tribunal, August 5, 2003). Accordingly, and in view of the foregoing, the only questions presented in this case are whether North Country has established that the audit method employed was unreasonable and whether the amount of tax assessed as the result of the application of the method used in this case was erroneous (*Matter of Surface Line Operators Fraternal Organization*). On this score, conclusory allegations of error are insufficient to show that the selected method of audit was unreasonable or that the amount of tax determined thereby was erroneous (*Matter of Vebale Edibles*).

C. Petitioner has not established that the audit method was unreasonable or that the amount of tax determined by application of such method was erroneous. The reason for a taxpayer's failure to provide adequate books and records is largely irrelevant to the Division's right to turn to indirect audit methodologies in determining the amount of tax due in the face of



such failure (*Matter of Sole to Sole, Inc.*, Tax Appeals Tribunal, July 1, 1993). Further, having established the inadequacies of a taxpayer's records, the Division is under no obligation to utilize one indirect method of audit as opposed to another, but rather must only select a method of audit reasonably calculated to determine the amount of tax due (*Matter of Grant Co. v. Joseph*). Nor is a taxpayer entitled to have an audit performed upon its records in part or in whole when, as here, such records are incomplete and inadequate (*Matter of Estate of Manno v. Tax Commn.*, 147 AD2d 805 [1989], *lv denied* 74 NY2d 610 [1989]).

D. Given that North Country was closed at the time the subject audit was being undertaken, the Division's use of its observation test conducted as part of an earlier audit, the results of which were agreed to by North Country, was a reasonable course of action. In this regard, the fact that North Country's business operations had ceased prior to the time the subject audit was commenced limited the types of audit which the auditor could conduct. For example, the fact that North Country was not in business at the time of the audit foreclosed the Division's opportunity to undertake an observation-of-sales audit method based on a more current period. In the same vein, a taxpayer's failure to provide records likewise limits audit options. For instance, a lack of purchase invoices and of suppliers limits the Division's ability to undertake a purchase markup audit method. In fact, the same absence of sales records as was found here also existed for the earlier audits of North Country's business, and North Country's own method of preparing sales tax returns was consistently based upon daybooks and estimates as opposed to reliance upon sales records. Under these circumstances, and notwithstanding that the observation of sales upon which the Division's calculations were premised occurred as part of an earlier audit, the Division's resort to the use of such method of audit and was a reasonable method of

determining North Country's sales tax liability for the period in issue (*see Matter of Mustafa*, Tax Appeals Tribunal, December 27, 1991).

E. North Country, in essence, appears to take issue with the Division's audit method and result because it is imprecise and because a different method might yield a better, i.e., less imprecise, result. Apparently, North Country's view is that using the cash register tapes for the time period of their availability, as was done in the alternative calculations proposed by North Country, would lead to such a better result. As a general proposition, any imprecision in the results of an audit arising by reason of a taxpayer's own failure to maintain adequate and accurate records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (*Matter of Markowitz; Matter of Meyer*). The additional calculations performed and provided by North Country's representatives are simply another view of the application of an estimation method of determining North Country's liability. Such calculations include various assumptions and are not premised upon either complete records of sales, or even to the extent sales records were produced, upon the type of records required (i.e., records of sales showing each sale and the taxable or nontaxable status thereof.) Finally, it remains that even under North Country's own method of calculation, a substantial underreporting and underpayment of tax results. Accordingly, the method of audit applied by the Division to the circumstances presented in this case, and the results derived therefrom, are sustained.

F. North Country has not provided evidence or argument which would support reduction or abatement of the penalties imposed, and the same are, therefore, sustained. In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). The Tribunal explained that "[b]y first requiring the imposition of penalties (rather than merely allowing them at the Commissioner's

discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [citations omitted]” (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992). Here, North Country lacked records of its sales, as are required to be maintained, and the balance of petitioner’s records were incomplete. Further, this was the third audit of North Country’s business, and each audit uncovered essentially the same failures with regard to record keeping. As noted earlier, even North Country’s own recalculation results in a substantial underreporting and underpayment of tax. Hence, there is no basis for abatement of penalties properly imposed.

G. Petitioner St. James Colonial Deli, Inc. has conceded its liability as a bulk sale purchaser for the sales tax assessed against North Country, and the same is therefore sustained.

H. The petitions of North Country Catering, Inc., and St. James Colonial Deli, Inc., are hereby denied and the notices of determination dated August 10, 2006 (as to petitioner North Country) and August 11, 2006 (as to petitioner St. James) are sustained.

DATED: Troy, New York  
September 18, 2008

/s/ Dennis M. Galliher  
ADMINISTRATIVE LAW JUDGE