

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
YING FENG WANG	:	
for Revision of a Determination or for Refund of	:	DETERMINATION
Sales and Use Taxes under Articles 28 and 29 of the	:	DTA NO. 822003
Tax Law for the Period June 1, 2003 through	:	
May 31, 2006.	:	

Petitioner, Ying Feng Wang, 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, 2003 through May 31, 2006.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on November 7, 2008 with all briefs to be filed by March 20, 2009. Petitioner appeared by Hinman, Howard & Kattell, LLP (Fredeick A. Griffen, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert Maslyn, Esq., of counsel).

ISSUE

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

FINDINGS OF FACT

1. During the periods in issue, petitioner, Ying Feng Wang, was the sole proprietor of a restaurant known as the New Far East Kitchen (the restaurant) in Binghamton, New York. The

restaurant sold food for eating on the premises and for take-out. When one entered the restaurant, there were tables to the left and a counter on the right. The kitchen was located behind the counter. The restaurant was located in a plaza which included a “Giant” grocery store and a few other small stores. The restaurant and the grocery store were adjacent to each other.

2. On or about March 17, 2005, an investigator conducted a survey of the restaurant to determine whether an estimate of the sales of the business was comparable to what the business reported on its sales tax returns. At the time of the survey, the investigator was familiar with the restaurant because it was located near her home and she had previously purchased food there. The Division did not advise petitioner that it was conducting a survey.

3. In certain respects, the methodology for the survey on March 17, 2005 is similar to the procedure which the Division follows when it conducts an observation test. In the instance of the survey, the auditor sat in an automobile from 11:00 A.M. to 3:00 P.M., approximately 15 to 20 feet away from the business, and counted 48 customers. She then assigned a sales price of \$4.00 per customer which was lower than any of the lunch specials. The 48 customers, at \$4.00 a bag, resulted in estimated lunch sales of \$192.00. On the basis of her previous experience, the auditor estimated that the lunch sales were 30 percent of the daily sales which resulted in an estimate of total daily sales of \$640.00. Approximately one week after observing the restaurant, the investigator prepared a survey report which contained an estimate of the gross sales of the business. When the investigator submitted her work to her supervisor, it was decided that an audit should be conducted.

4. On May 4, 2006, the Division sent an appointment letter to petitioner advising him that the store’s sales and use tax records had been scheduled for a field audit for the period June 1, 2003 through May 31, 2006. The letter stated 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.

5. After speaking with petitioner’s representative, the auditor was sent some bank statements, food invoices and utility invoices. However, no sales records were provided and the auditor did not find any of the information submitted to be useful. The auditor spoke with petitioner’s representative a second time and told him that she needed to see the records on the records request list. In particular, the auditor asked for sales tax returns, the backup to the returns, sales records and cash register tapes. Cash register tapes, guest checks, sales invoices or other source documents were never provided and at the end of August 2006, petitioner’s accountant explained that the taxpayer did not have the records which were requested by the Division.

6. The Division did not consider the records provided to be sufficient for the conduct of a detailed audit and therefore it decided to perform an observation test of the restaurant.

7. On September 14, 2006, the Division attempted to conduct an observation of the restaurant from 11:00 A.M. to 10:00 P.M. The Division knew the hours of the restaurant from reviewing a menu. On this day, two auditors sat inside the restaurant near the cash register and observed the sales.

8. As the observation progressed, the Division noted the following:

a.) On the basis of the prior survey of the restaurant, the investigators anticipated that six individuals would be working at the restaurant. However, on this day only two individuals were working.

b.) There were instances where customers were undercharged.

c.) The Division noted that the telephone in the restaurant did not ring. When the Division placed a call to the restaurant, it rang in a different location.

d.) People had to wait an inordinate amount of time to be served and there were many people who were not being served. During the day it was noted that seven people left after being told that it would be at least a half hour before their meal would be ready.

9. Following the observation, the Division concluded that the results were skewed and could not be used. As a result, the Division conducted a second observation on September 21, 2006. An auditor backed her car into a parking space with the driver's seat facing the entrance to the restaurant. Except for a period of about one-half hour, when a delivery truck was blocking her view, she could clearly see an entrance to a portico which led to a doorway of the restaurant and also the doorway. Every person leaving the restaurant from the front doorway walked in the direction of the investigator. When the auditor was unable to see the entrance to the restaurant, she would get out of her car and select a location for a clearer view.

10. The auditor estimated the amount of the sale by the size of the packaging that the customer used to carry the food out of the store. The food was placed into one of three categories: small bag, box and grocery bag, and a sales price was assigned to an item or items based on the size of the packaging. Petitioner's and the Giant's brown bags, plastic grocery bags and boxes were similar in design and color except that petitioner's brown bags had no markings. Nevertheless, there were sufficient differences between the bags from the restaurant and the grocery store that the investigator was able to distinguish one from the other. The Giant plastic bags said Giant on both sides. The Giant paper bags said Giant on one side and had a message on the other side which changed with the season. The restaurant's plastic bags said thank you on

them. The restaurant's brown paper bags did not have any writing or design on them. There was usually a menu stapled to the restaurant bag.

11. According to the menu of the restaurant, the lunch specials were \$4.50 to \$4.60. Therefore, for the purpose of estimating sales, the auditor determined that a small bag was \$4.00, which was less than the cost of a combination plate. She estimated a box to be \$10.00 and a grocery bag to be \$8.00.

12. Sales were observed from 11:00 A.M. to 2:30 P.M. During this period, the auditor saw the sale of 38 small bags at \$4.00 each, four boxes at \$10.00 each and one grocery bag at \$8.00 dollars for total lunch sales of \$200.00.

13. For the dinner specials, the auditor again referred to the menu and noted that the price of the dinner specials ranged from \$5.40 to \$6.45. With this amount in mind, the auditor estimated that the cost of a small bag was \$6.00, a large box to be \$20.00, a regular box to be \$15.00, a grocery bag to be \$10.00 and a large bag to be \$8.00.

14. Since the auditor was not present at the restaurant from 2:30 P.M. to 4:00 P.M. or from 8:00 P.M. until 10:00 P.M., the Division used the result of the prior observation test on September 14, 2006 to determine sales during the time the auditor was not present. That is, the Division used the results from the 3:00 P.M. hour, the 8:00 P.M. hour and the 9:00 P.M. hour of the prior observation. While the Division believed that the results were skewed, it felt that the percentage of sales between lunch and dinner would be accurate. The Division determined that 45¹ percent of dinner sales occurred during the period that the auditor was not present. Total

¹ On September 14, 2006, \$98.13 worth of sales occurred during the hours of 3:00 pm, 8:00 P.M. and 9:00 P.M. while total sales observed during the observation test on September 14, 2006 during the 4:00 P.M. through 7:00 P.M. hours were \$217.96, and \$98.13 divided by \$217.96 is 45%.

dinner sales observed between the hours of 4:00 P.M. and 8:00 P.M. were \$966.00 and sales not observed by the investigator were \$434.91.

15. The Division concluded that the taxable sales on September 21, 2006 were \$1,600.91, which was calculated as follows:

Lunch sales	\$200.00
Dinner sales on September 21, 2006	966.00
Total off-hour sales	<u>434.91</u>
Total sales on September 21, 2006	\$1,600.91

16. On the basis of a 360-day year, the Division calculated the total restaurant sales for the year. This amount was then divided by four to determine the quarterly gross sales. The quarterly gross sales were multiplied by the applicable tax rate, which changed over the course of the audit period, to determine the sales tax due. The amount of sales tax paid was subtracted from the sales tax due to determine that additional sales tax was due in the amount of \$123,701.21.

17. On the basis of its audit, the Division issued a Notice of Determination, dated April 30, 2007, to petitioner which assessed a deficiency of sales and use taxes in the amount of \$123,701.21, plus interest in the amount of \$47,175.70 and penalty in the amount of \$47,330.70, for a balance due of \$218,207.61. Both statutory and omnibus penalties were assessed pursuant to Tax Law § 1145(a)(1)(i) and (vi) because the additional tax due was more than 25 percent of the audited tax due.

18. In accordance with Administrative Procedure Act § 307(1), petitioner's proposed findings of fact have been generally accepted and incorporated herein. However, proposed findings of fact 1, 27, 31, 37, 40, 41, 42, 46 and 48 were rejected as irrelevant. Proposed findings

of fact 4, 23, 34, 45 were rejected because they were argumentative. Proposed finding of fact 4 was modified to conform to the record. Additional findings of fact were also made.

SUMMARY OF PETITIONER'S POSITION

19. Petitioner raises objections to the reasonableness of the audit method and the accuracy of the audit result. Although petitioner does not challenge the use of an observation test, he maintains that the observation test was flawed. In his opening brief, petitioner submits that the estimate of total daily sales of \$1,600.91 is excessive. This argument is premised upon the testimony of one of the Division's investigators that stated that luncheon sales in this type of business are usually 30 percent of the total daily sales. Petitioner then notes that this testimony indicates that petitioner's total sales would be approximately \$640.00. Petitioner contends that disregarding the results of the first survey is arbitrary.

Petitioner next argues that the Division presented testimony on several occasions that the results of the September 14th observation were skewed and therefore the September 21st test had to be conducted. It is submitted that it was arbitrary to nullify the September 14th test but use certain sales from it. Lastly, petitioner asserts that it is quite likely that the auditor made the mistake of attributing sales to petitioner which were actually sales of the adjacent grocery store.

In his reply brief, petitioner explains that his argument has two parts. First, petitioner submits that the first observation on March 17, 2005 should have been used since it was conducted without petitioner's knowledge and since the relative percentages of sales between the different meal times are consistent with sales averages according to an investigator who is familiar with the area and the businesses therein. Second, petitioner maintains that it was invalid to use the results of the September 14, 2006 observation to determine the sales during the hours which were missing during the September 21, 2006 test. In this regard, petitioner contends that,

by reason of the use of the September 14, 2006 observation, the Division's calculation of percentages of sales during certain hours was erroneous, and further, if the findings of the September 14, 2006 were to be used, the Division should have used the figures it observed from the September 14, 2006 test to complete the missing hours from the September 21, 2006 test.

CONCLUSIONS OF LAW

A. In general, Tax Law § 1105(d) imposes sales tax on the sales of food where the sale is for consumption on the premises, where the item is sold or for consumption off the premises and where the item is sold in a heated state in the same form used by food stores which are not principally involved in selling foods ready to be eaten (Tax Law § 1105[d]; 20 NYCRR 527.8[a]). Any person making taxable sales is a "vendor" under Tax Law § 1101(b)(8). As such, petitioner was "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" (*Matter of AGDN, Inc.*, Tax Appeals Tribunal, February 6, 1997). The records required to be maintained "include a true copy of each sales slip, invoice, receipt, statement or memorandum." (Tax Law § 1135[a].)

B. Here, it is undisputed that petitioners failed to produce any sales records. Since petitioners did not maintain any records of individual sales, there was a violation of Tax Law § 1135(a) (*see Matter of Goldner v. State Tax Commn.*, 70 AD2d 978, 418 NYS2d 477 [1979], *lv denied* 48 NY2d 608, 423 NYS2d 1025[1979]). Under such circumstances, the Division was authorized to use an estimated audit method, so long as such method was reasonably calculated to reflect the taxes due (*see Matter of AGDN, Inc.*). The use of an observation test to determine sales is a well established and acceptable audit methodology (*see e.g. Matter of Del's Mini Deli,*

Inc. v. Commr., 205 AD2d 989, 613 NYS2d 967 [1994]; *Matter of Club Marakesh v. Tax Commn.*, 151 AD2d 908, 542 NYS2d 881, *lv denied* 74 NY2d 616, 550 NYS2d 276[1989]).

C. In this instance, petitioner has not challenged the Division's position that he failed to produce adequate books and records or that the Division was entitled to estimate the amount of tax due. Where, the use of external indices is appropriate, the burden of proof lies with the taxpayer to show by clear and convincing evidence that the audit method led to unreasonably inaccurate results or that the amount of tax assessed was inaccurate (*Matter of Del's Mini Deli, Inc. v. Commr.*).

D. Petitioner's argument that the Division should have relied upon the results of the first observation of the restaurant is unpersuasive because it fails to recognize that the procedure conducted on March 17, 2005 was a survey, which is different in purpose and scope from the observation test that was conducted on September 21, 2006. The purpose of the survey was to make an estimate of the gross sales of the business and compare that to what was reported on the sales tax returns in order to determine if an audit should be conducted. In performing this estimate, the investigator attempted to be conservative and the investigator's estimate of average daily sales of \$640.00 was merely a conservative estimate based on audit experience.

In contrast to the survey, when the audit was conducted the auditor attempted to accurately determine the restaurant's gross sales and, thereafter, the amount of sales and use taxes due. The difference in the methodology is demonstrated by the way that lunch prices were determined. During the survey the Division merely used \$4.00 per meal without any reference to the menu prices. This price was lower than the lunch specials. In contrast, when the observation test was conducted, the Division based its prices for the various packaging on the menu prices. Obviously, the latter approach would lead to a more accurate finding of gross sales.

A second difficulty with petitioner's argument is that the burden of proof is on petitioner to show by clear and convincing evidence that the audit method led to unreasonably inaccurate results or that the amount of tax assessed was inaccurate (*Matter of Del's Mini Deli, Inc. v. Commr.*). Here, petitioner has not presented any sales records to show that the observation test led to inaccurate results, and therefore, this argument must also be dismissed.

E. Petitioner's contention that it was arbitrary to disregard the amount of sales from the September 14, 2006 survey but utilize proportions from the same amounts is also rejected. If the conduct which caused the outcome of the survey to be skewed affected the survey in the same proportion throughout the hours of the survey, then the proportions would be correct even though the absolute amounts would be inaccurate. Here, petitioner has not presented any evidence showing that the conduct which caused the findings to be skewed did not affect the outcome of the survey equally throughout the hours of the survey. Therefore, petitioner has not presented any evidence to show that utilizing the proportions led to unreasonably inaccurate results or that the amount of tax was inaccurate.

F. Lastly, petitioner asserts that it is quite likely that the auditor made the mistake of attributing sales to petitioner which were actually the sales of the adjacent grocery store. The clear weight of the evidence in the record does not support this proposition. The record shows that every person leaving the restaurant from the front doorway walked in the direction of the investigator and she had a clear view of the bag each was carrying.² There were sufficient differences between the bags for the restaurant and the grocery store that she was able to

² It was possible for a person to leave from another doorway. If a customer chose to leave in this manner, that sale would not have been counted and the amount of tax assessed would have been correspondingly less.

distinguish one from the other (*see* Finding of Fact 10). If she were unable to see what a customer was carrying, she would get out of her car to get a better view.

G. The petition of Ying Feng Wang is denied and the Notice of Determination, dated April 30, 2007, is sustained together with such penalty and interest as may be lawfully due.

DATED: Troy, New York
September 10, 2009

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE