STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

HUAQUECHULA RESTAURANT CORPORATION :

:

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 September 1, 2003 through August 31, 2006. :

In the Matter of the Petition :

of :

FIDEL J. LIRA :

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 March 1, 2004 through August 31, 2006. :

DETERMINATION
DTA NOS. 822285 AND 822298

Petitioner Huaquechula Restaurant Corporation 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 September 1, 2003 through August 31, 2006.

Petitioner Fidel J. Lira 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 March 1, 2004 through August 31, 2006.

A consolidated hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on

June 10, 2009 at 10:30 A.M., with all briefs to be submitted by September 25, 2009, which date began the six-month period for the issuance of this determination. Petitioners appeared by Ballon Stoll Bader & Nadler, PC (Norman R. Berkowitz, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Robert Tompkins, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation's determination upon audit that petitioner Huaquechula Restaurant Corporation owed additional sales tax, plus interest and penalties, was proper and should be sustained.

II. Whether petitioner Fidel J. Lira was personally liable for sales tax due on behalf of Huaquechula Restaurant Corporation as a person required to collect and pay tax under Tax Law §§ 1131 and 1133.

FINDINGS OF FACT

1. Petitioner Huaquechula Restaurant Corporation owned and operated the Guadalajara Mexican Restaurant located in Briarcliff Manor, New York. Fidel J. Lira was the corporation's president, sole officer and 100% shareholder. The restaurant hours were 11:00 A.M. to 10:00 P.M., Sunday through Thursday, and 11:00 A.M. to 11:00 P.M., Friday and Saturday.

2. On August 25, 2006, the Division of Taxation (Division) sent a letter to Huaquechula Restaurant Corporation stating that a sales and use tax field audit of the business operation was to be conducted for the period September 1, 2003 through August 31, 2006. The Division's letter requested that all of the business's books and records for the audit period be available for review. Among the records specifically requested were the sales tax records, New York State corporation tax returns, sales invoices, exemption documents, fixed asset purchase and sales invoices, expense purchase invoices, bank statements, cash receipts journal, cash disbursements

journal, federal income tax returns, cash register tapes, depreciation schedules and canceled checks.

3. On November 17, 2006, the corporation, by its accountant, executed a Consent Extending Period of Limitations for Assessment of Sales and Use Taxes under Articles 28 and 29 of the Tax Law extending the period in which to assess sales and use taxes due for the period September 1, 2003 through May 31, 2004 to June 20, 2007.

4. The corporation did not provide the auditor with sales invoices, sales journals, cash sales receipts, credit card sales receipts, cash register tapes, guest checks or other source documentation detailing the amount of retail sales of the business operation. In addition, the corporation did not provide the auditor with fixed asset purchase and sales invoices, expense purchase invoices or exemption documents. The only documents made available to the auditor were the corporation's U.S. corporation income tax returns, form 1120.

As a result of the inadequacy of the books and records relating to the amount of the business's sales, because of the inability to trace any transaction back to the original source or forward to a final total, the auditor determined that a detailed audit would not be possible and decided to perform an observation test.

5. On January 29, 2007, the Division mailed a letter to the corporation's accountant stating that the books and records of the business operation were insufficient to determine if the proper amount of sales tax had been reported for the audit period. As a result, the Division indicated that it would be conducting an observation of the business to record sales activity for an entire day.

6. On February 16, 2007, a Friday, the auditor went to the business unannounced to conduct an observation test. Petitioner's representative refused to allow the auditor to conduct

the observation and told him to leave the premises. In a subsequent telephone conversation, the representative stated that he would allow an observation on a Monday, Tuesday or Wednesday only, and with a specific day scheduled. The auditor explained that only an unannounced observation could be performed to prevent any manipulation that could distort the test.

7. Having been provided with no source documentation that established the amount of the business's sales and denied the opportunity to perform an observation test, the auditor decided to use a previously performed unannounced head count to estimate the amount of the corporation's sales. On January 19, 2007, an investigator of the Division had observed and counted the number of people entering the restaurant between the hours of 5:30 P.M. and 10:30 P.M. The investigator counted 239 people during that time frame.

The auditor determined an hourly average of customers of 47.8 (239/5), which was applied to daily business hours of 7 per day (5 hours for dinner and 2 hours for lunch) to arrive at a total number of customers per day of 335. An average check price per customer was determined by averaging the price of meals from the menu. In determining the average, the auditor used the cost of meals, salads and children's meals and did not use the cost of any appetizers, soups or desserts although they were indicated on the menu. An average beverage price of $3.00 was added to determine the average check price per person. Alcoholic beverages were listed on the menu, but were not considered in calculating the average beverage price.

8. The auditor computed daily sales of $6,646.40 by multiplying the daily head count of 335 by the average check price of $19.84. The daily sales figure of $6,646.40 was multiplied by the total number of days of the audit period of 1,096 to determine audited taxable sales of $7,284,454.40 for the period at issue. Reported taxable sales of $1,715,421.00 were subtracted from audited taxable sales to arrive at additional taxable sales per audit of $5,569,033.40. An

error rate calculation was used by the auditor to determine the additional sales per quarter and the applicable sales tax rate was applied to arrive at additional sales tax due per quarter. Total additional sales tax due for the audit period was $410,273.00.

9. Bank statements were obtained by the auditor through the issuance of subpoenas to the corporation's banks. The auditor determined that bank deposits for the period at issue exceeded reported sales by $2,242,920.48.

10. The auditor used the corporation's U.S. corporation income tax returns to determine the amount of expense and asset purchases for the period at issue. As no records were provided by petitioners to establish that sales tax had been paid on these purchases, the auditor assessed sales tax on recurring expense purchases of $106,714.67 and asset purchases of $141,122.96, resulting in additional sales tax due of $7,861.71 and $10,396.58, respectively.

11. On April 30, 2007, the Division of Taxation issued to petitioner Huaquechula Restaurant Corporation a Notice of Determination asserting additional sales tax due for the period September 1, 2003 through August 31, 2006 in the amount of $428,531.18, plus penalty and interest.

On the same date, the Division of Taxation issued to petitioner Fidel J. Lira, as an officer or responsible person of Huaquechula Restaurant Corporation, a Notice of Determination asserting additional sales tax due for the period March 1, 2004 through August 31, 2006 in the amount of $364,350.05, plus penalty and interest.

12. As previously noted, Fidel J. Lira was the corporation's president, sole officer and 100% shareholder. He signed, as president, the sales and use tax returns for the quarters ended May 31, 2004 through August 31, 2006, as well as the checks which accompanied the returns in payment of the sales tax due. Mr. Lira also signed, as president, the corporation's general

business corporation tax returns, form CT-3, for the years 2003, 2004, 2005 and 2006, as well as the attached checks. Mr. Lira was present at the hearing but did not testify.

SUMMARY OF THE PARTIES' POSITIONS

13. Petitioners first claim that the Division did not follow proper procedures in determining the adequacy of the corporation's records. According to petitioners, by issuing subpoenas for third-party information prior to reviewing the records, the Division prejudged the adequacy of the corporation's records.

Petitioners' second claim is that the methodology adopted was not reasonably calculated the reflect the proper tax due, but rather to achieve the highest possible tax due.

Petitioners next claim that the estimated audit methodology was not properly utilized and the computations of the head count, average meal price, and capital and expense purchases were inaccurate.

With regard to the Notice of Determination issued to the corporation, petitioner claims that the Division failed to introduce any proof that the notice was mailed by certified or registered mail as required by the Tax Law.

Finally, petitioner Fidel J. Lira claims that the Division failed to conduct an analysis of the responsible officer factors before issuing the Notice of Determination to him, requiring a finding that he was not under a duty to act on behalf of the corporation with regard to the sales tax due.

14. The Division of Taxation claims that it properly requested the corporation's books and records, that no records were provided and that petitioners have failed to establish any errors made in the estimated methodology used or the amount of tax determined to be due. The Division further claims that it was not required to present proof of certified mailing of the notice

because the corporation failed to establish a prima facie case in asserting a statute of limitations defense. Finally, the Division alleges that sufficient facts are contained in the record to establish Mr. Lira's responsibility for the taxes due and that he failed to meet his burden of proof to demonstrate by clear and convincing evidence that he was not a responsible officer.

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 is 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 . . . ." 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 the 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***., 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 the restaurant's books and records. In response, petitioners presented only the corporation's U.S. corporation income tax returns. These records were clearly insufficient to verify taxable sales since there were no sales records which would allow the auditor to trace any transaction back to the original source or to verify the amount of taxable sales. The poor state of the records presented made it impossible to verify taxable sales through a complete audit from which the exact amount of tax due could have been determined. Accordingly, it was proper for the Division to resort to the use of external indices (***Matter of Karay Restaurant Corp. v. Tax Appeals Tribunal***, 274 AD2d 854, 711 NYS2d 853 [2000], ***lv denied*** 96 NY2d 702, 722 NYS2d 794 [2001]; ***Matter of Sarantopoulos***

v. Tax Appeals Tribunal, 186 AD2d 878, 589 NYS2d 102 [1992]). The courts have upheld the use of observation tests as an external index and have found it reasonable to extrapolate the results of a one-day observation or multiple-day test over a multi-year audit period (***see Matter of Sarantopoulos v. Tax Appeals Tribunal***; ***Matter of Vebol Edibles v. Tax Appeals Tribunal***, 162 AD2d 765, 557 NYS2d 678 [1990], ***lv denied*** 77 NY2d 803, 567 NYS2d 643 [1991]). Accordingly, it was reasonable to utilize an observation test to estimate the restaurant's sales and the resultant sales tax liability (***see Matter of Marte***, Tax Appeals Tribunal, August 5, 2004).

D. Initially, petitioners claim that the Division did not follow the long established procedure to determine the accuracy of the corporation's books and records. According to petitioners, because the Division requested information from third-party suppliers prior to examining the corporation's books and records, the Division cannot resort to indirect audit methodologies to determine the tax due from petitioners. Petitioners contend that these requests indicated that the Division had predetermined that the corporation's books and records were inadequate.

The purpose of the request and examination of a taxpayer's books and records is to insure that a taxpayer who maintains records as required will have those records examined by the Division on audit. As the court in ***Matter of Chartair, Inc. v. State Tax Commn.*** stated, "the honest and conscientious taxpayer who maintains comprehensive records as required has a right to expect that they will be used in any audit to determine his ultimate tax liability." (***Id*** at 44.) Consequently, an indirect audit methodology cannot be used unless a taxpayer's records are so insufficient that its sales cannot be verified or such records are unavailable (***see Matter of Christ Cella, Inc. v. State Tax Commn.***). Only after the Division has requested and thoroughly reviewed a taxpayer's records and determined them to be inadequate can the Division use an

indirect audit method. Clearly, in this matter, where the corporation did not produce any records pertaining to its business operation in response to the Division's request, the Division was justified in employing an indirect audit methodology.

E. Petitioners next argue that the Division's estimated methodology was not reasonably calculated to reflect the proper tax due but was used to achieve the highest possible amount of tax due. Petitioners also claim that the head count did not properly account for employees, children and two large parties occurring at the time of the head count. Finally, petitioners argue that it was unreasonable to assume that no sales tax had been paid on any of the capital or expense purchases.

The forgoing arguments do not satisfy the taxpayers' burden of proving by clear and convincing evidence that the audit methodology was erroneous or that the assessment was incorrect (***see Matter of Sarantopoulos v. Tax Appeals Tribunal***). Petitioners' arguments overlook the fact that the Division computed the average cost of a customer's meal by including in its cost computation the price of meals, salads and children's meals, and excluding the cost of any appetizers, soups or desserts, although they appeared on the menu. In addition, the average beverage price was computed without the cost of alcoholic beverages, although they were also listed on the menu. Finally, petitioners cannot now claim that the observation was flawed when they themselves refused the auditor an opportunity to conduct an observation test inside the restaurant, where more accurate customer numbers, costs of meals and beverages ordered could have been obtained and used in the audit calculation. There is no evidence in the record to show that the adjustments to sales were unwarranted.

F. Petitioners' claim that it was unreasonable for the auditor to assume that no sales tax had been paid on any of its capital or expense purchases is without merit. Sales tax is imposed

upon the retail sale of tangible personal property (Tax Law § 1105[a]). Petitioners presented no documentation that such sales tax had been paid on its purchases.

G. Petitioners, in essence, appear to take issue with the Division's audit result because it is imprecise. As a general proposition, any imprecision in the results of an audit arising by reason of a taxpayer's own failure to keep and maintain records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (***Matter of Markowitz v. State Tax Commission; Matter of Meyer v. State Tax Commission***). The burden of proof rested upon petitioners to show by clear and convincing evidence that the audit method was flawed or the amount of tax assessed was incorrect (***Matter of Surface Line Operators Fraternal Org. v. Tully***). Petitioners have not presented any evidence to satisfy this burden with regard to any of their allegations as to the audit methodology or the results thereto. Ultimately, petitioners' failure to maintain or provide any records of its purchases and sales does not provide a basis for changing the Division's audit results.

H. Where a taxpayer raises a statute of limitations defense to an assessment, the taxpayer has the burden of making a prima facie showing of when the limitations period commenced, when it expired and the mailing or receipt of a statutory notice after the running of the period. Where the taxpayer meets this burden, the Division then has the burden of going forward to show that the statutory bar does not apply (***Matter of Pittman***, Tax Appeals Tribunal, February 20, 1992; ***Matter of Jencon***, Tax Appeals Tribunal, December 20, 1990). Since evidence as to when a limitations period commenced (such as the date of filing a return) and evidence as to the date of receipt of a statutory notice is ordinarily within the knowledge of the taxpayer, it is appropriate that the taxpayer bear the burden of establishing a prima facie case in order to avail itself of the statute of limitations defense. Here, petitioners did not introduce any evidence to establish when

the statute of limitations period commenced. Therefore, the Division was not required to provide proof that it properly mailed the notices of determinations to petitioners.

I. Tax Law § 1133(a) imposes upon any person required to collect the tax imposed by Article 28 of the Tax Law personal liability for the tax imposed, collected or required to be collected. A person required to collect tax is defined to include, among others, corporate officers and employees who are under a duty to act for such corporation in complying with the requirements of Article 28 (Tax Law § 1131[1]).

J. The mere holding of corporate office does not, per se, impose tax liability upon an office holder (***see Matter of Vogel v. New York State Dept. of Taxation & Fin.***, 98 Misc 2d 222, 413 NYS2d 862 [1979]; ***Matter of Chevlowe v. Koerner***, 95 Misc 2d 388, 407 NYS2d 427 [1978]; ***Matter of Unger***, Tax Appeals Tribunal, March 24, 1994, ***confirmed*** 214 AD2d 857, 625 NYS2d 343 [1995], ***lv denied*** 86 NY2d 705, 632 NYS2d 498 [1995]). Rather, whether a person is an officer or employee liable for tax must be determined upon the particular facts of each case (***Matter of Cohen v. State Tax Commn***., 128 AD2d 1022, 513 NYS2d 564 [1987]; ***Matter of Hall***, Tax Appeals Tribunal, March 22, 1990, ***confirmed*** 176 AD2d 1006, 574 NYS2d 862 [1991]; ***Matter of Martin***, Tax Appeals Tribunal, July 20, 1989, ***confirmed*** 162 AD2d 890, 558 NYS2d 239 [1990]; ***Matter of Autex Corp.***, Tax Appeals Tribunal, November 23, 1988). Factors to be considered, as set forth in the Commissioner's regulations, include whether a person is authorized to sign the corporation's tax returns, was responsible for managing or maintaining the corporate books or was permitted to generally manage the corporation (20 NYCRR 526.11[b][2]). As summarized in ***Matter of Constantino*** (Tax Appeals Tribunal, September 27, 1990):

> [t]he question to be resolved in any particular case is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. The case law and the decisions of this Tribunal have identified a variety of factors as indicia of responsibility: the individual's status as an officer, director, or shareholder; authorization to write checks on behalf of the corporation; the individual's knowledge of and control over the financial affairs of the corporation; authorization to hire and fire employees; whether the individual signed tax returns for the corporation; the individual's economic interest in the corporation (***Cohen v. State Tax Commn***, ***supra***, 513 NYS2d 565; ***Blodnick v. State Tax Commn***., 124 AD2d 437, 507 NYS2d 536, 538, ***appeal dismissed*** 69 NY2d 822, 513 NYS2d 1027; ***Vogel v. New York State Dept. of Taxation & Fin***., ***supra***, 413 NYS2d at 865; ***Chevlowe v. Koerner***, ***supra***, 407 NYS2d at 429; ***Matter of William Barton***, [Tax Appeals Tribunal, July 20, 1989]; ***Matter of William F. Martin***, ***supra***; ***Matter of Autex***, ***supra***).

K. Summarized in terms of a general proposition, the issue to be resolved is whether petitioners had, or could have had, sufficient authority and control over the affairs of the corporation to be considered persons under a duty to collect and remit the unpaid taxes in question (***Matter of Constantino***; ***Matter of Chin***, Tax Appeals Tribunal, December 20, 1990). In order to prevail, petitioner Fidel J. Lira "was required to establish by clear and convincing evidence that he was not an officer having a duty to act on behalf of the corporation, i.e., that he lacked the necessary authority or he had the necessary authority, but was thwarted by others in carrying out his corporate duties through no fault of his own (citations omitted)" (***Matter of Goodfriend***, Tax Appeals Tribunal, January 15, 1998).

L. Fidel J. Lira was the corporation's president, sole officer and 100% shareholder. He signed, as president, the New York State and local sales and use tax returns for the quarters ended May 31, 2004 through August 31, 2006, as well as the checks which accompanied the returns in payment of the sales tax due. Mr. Lira also signed, as president, the corporation's general business corporation tax returns, for the years 2003, 2004, 2005 and 2006, as well as the attached checks. Petitioners were obviously free to call witnesses and to present evidence to

refute any of the evidence offered by the Division, but chose not to do so. Further, although present at the hearing, Mr. Lira chose not to testify on his own behalf. Under the circumstances, it is reasonable to take the strongest possible negative inference from petitioner's failure to testify to contradict the Division's case (***see Matter of Drebin***, Tax Appeals Tribunal, March 27, 1997).

M. The petitions of Huaquechula Restaurant Corporation and Fidel J. Lira are denied, and the notices of determination dated April 30, 2007 together with penalties and interest thereon, are sustained.

DATED: Troy, New York
March 25, 2010

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE