

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LINDENHURST BAGEL & DELI, INC.	:	
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 May 31, 2006.	:	
	:	DETERMINATION
	:	DTA NOS. 822295, 822296
	:	AND 822297
In the Matter of the Petitions	:	
of	:	
JAMES COLTON AND	:	
DOMINICK A. FORTE	:	
for Revision of Determinations or for Refund of	:	
Sales and Use Taxes under Articles 28 and 29 of	:	
the Tax Law for the Period December 1, 2003	:	
through May 31, 2006.	:	

Petitioner Lindenhurst Bagel & Deli, Inc., 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 May 31, 2006.

Petitioners James Colton and Dominick A. Forte 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 December 1, 2003 through May 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 January 7, 2009 at 10:30 A.M., with all briefs to be submitted by April 3, 2009, which date began

the six-month period for the issuance of this determination. Petitioners appeared by Roman Bellusci, CPA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Nicholas A. Behuniak, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation's determination upon audit that petitioner Lindenhurst Bagel & Deli, Inc., owed additional sales tax, plus interest and penalties, was proper and should be sustained.

II. Whether petitioners have established any facts or circumstances warranting the reduction or abatement of penalties imposed.

III. Whether petitioners James Colton and Domonick A. Forte were personally liable for sales tax due on behalf of Lindenhurst Bagel & Deli, Inc., as persons required to collect and pay tax under Tax Law §§ 1131 and 1133.

FINDINGS OF FACT¹

1. Petitioner Lindenhurst Bagel & Deli, Inc., operated a retail bagel store in Lindenhurst, New York. Lindenhurst Bagel filed an application for registration as a sales tax vendor, Form DTF-17, on October 7, 2003. The application was validated on October 15, 2003. The corporation filed state and local quarterly sales and use tax returns for the audit period beginning September 1, 2003 and ending May 31, 2006. Lindenhurst Bagel used the cash basis of accounting.

¹In accordance with New York State Administrative Procedure Act § 307(1), many of the Division of Taxation's proposed findings of fact have been accepted, in whole or in part, and incorporated herein. It is noted the Division of Taxation's proposed findings of fact 8, 32, 33, 34 and 35 have been rejected as being unnecessary for the determination.

Petitioners James Colton and Dominick A. Forte were each 50 percent stockholders of the corporation.

2. On August 15, 2006, the Division of Taxation (Division) sent a letter to Lindenhurst Bagel & Deli, Inc., stating that a sales and use tax field audit of the business operation was to be conducted for the period September 1, 2003 through May 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.

On September 21, 2006, the auditor requested that petitioners provide the fixed asset account details from the general ledger for the period September 1, 2003 through May 31, 2006.

3. On September 21, 2006, the corporation, by petitioner James Colton as president, 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 February 29, 2004 to March 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 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 bank deposits, check registers, a 2005 general ledger, federal tax returns and cash register tape summaries, or Z tapes. Z tapes do not list specific sales, but are a summary of the day's activity on the register.

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. The date chosen was November 30, 2006, a Thursday, which the auditor considered to be a reasonable representation of the corporation's business activity. The observation occurred between 5:00 A.M. and 3:30 P.M.

5. During the observation, the auditor recorded gross receipts of \$1,244.66, which included taxable sales of prepared foods of \$946.80, other taxable purchases of \$91.34 and nontaxable purchases of \$206.52. Sales tax of \$82.43 was removed from the gross receipts figure to arrive at taxable sales of \$955.71 for the day of the observation. The taxable sales determined by the auditor as a result of the observation was multiplied by 90, the number of days in a quarter, to arrive at taxable sales per quarter of \$86,013.90. The taxable quarterly sales figure was multiplied by eleven, the number of quarters in the audit period, to arrive at audited taxable sales for the audit period of \$946,152.90. The auditor subtracted the taxable sales reported by Lindenhurst Bagel during the audit period of \$74,566.00 to compute additional taxable sales for the audit period of \$871,586.90.

6. The auditor applied an inflation adjustment obtained from the Department of Labor, Bureau of Labor Statistics, on a quarterly basis which reduced total additional taxable sales for the audit period to \$836,497.20. Quarterly additional taxable sales, as reduced by the inflation adjustment, were multiplied by the applicable sales tax rate to arrive at additional sales tax due of \$72,796.74 for the audit period.

7. The \$955.71 in taxable sales as determined by the Division during its observation of the business operation of Lindenhurst Bagel on November 30, 2006 represents more than one-

tenth of the total taxable sales reported for a quarter. In contrast, one day's activity should have represented approximately one-ninetieth of a quarter's taxable sales.

8. On January 17, 2007, during the course of the audit, the auditor examined the summary register tapes (Z tapes) provided by Lindenhurst Bagel and determined them to be inadequate for establishing how each sale was recorded. The president of Lindenhurst Bagel, Mr. James Colton, explained to the auditor that he only saved the Z tapes, and no other cash register tapes were provided. The auditor explained to Mr. Colton, Mr. Forte and the corporation's representative that the Z tapes were inadequate.

9. Lindenhurst Bagel's cash register tapes for the day of the observation showed \$590.47 in nontaxable sales items as being sold for the day. The Division's physical observation showed \$206.52 of nontaxable sales items as being sold for the day.

10. The auditor performed a review of the corporation's capital accounting records and determined them to be inadequate because several invoices were missing and a lease agreement was not provided. The auditor next reviewed Lindenhurst Bagel's federal depreciation schedule for 2005 which contained items of equipment with a cost of \$109,411.00, goodwill with a cost of \$106,809.00 and leasehold improvements with a cost of \$63,780.00. The auditor requested that the business provide documentation to establish that sales tax had been paid on the purchases of the equipment and the leasehold improvements. Petitioners did not provide any records.

Having received no documentation to establish that sales tax had been paid on the equipment and the leasehold improvements, the auditor first totaled these purchases to arrive at taxable purchases of \$171,191.00. The auditor subtracted from this figure equipment purchases of \$46,079.00 because these items had been part of a bulk sale transfer on which sales tax had been paid, to arrive at taxable purchases where no sales tax had been paid of \$127,112.00. These

taxable purchases were multiplied by the applicable sales tax rate to compute additional tax due on taxable purchases of \$11,122.30.

Additional tax due as determined by the auditor based upon the observation test of sales and the review of taxable purchases totaled \$83, 919.04.

11. Petitioner Dominick A. Forte owned 50 percent of the shares of stock of Lindenhurst Bagel for the period at issue. According to the responsible person questionnaire completed by Mr. Forte, he participated in making significant business decisions and derived substantial income or had a substantial economic stake in the business. In addition, Mr. Forte had the authority to manage the business with knowledge and control over its financial affairs, pay or direct payments of credits, sign checks in the ordinary course of business, negotiate loans, borrow money for business, guarantee business loans and hire and fire employees. Mr. Forte stated that he devoted 50 percent of his time to the business operation.

12. Petitioner James Colton owned 50 percent of the shares of stock of Lindenhurst Bagel for the period at issue. According to the responsible person questionnaire completed by Mr. Colton, he prepared or supervised the preparation of sales tax returns and ensuring the remittance of tax, participated in making significant business decisions and derived substantial income or had a substantial economic stake in the business. In addition, Mr. Colton had the authority to manage the business with knowledge and control over its financial affairs, pay or direct payments of credits, sign checks in the ordinary course of business, negotiate loans, borrow money for business, guarantee business loans and hire and fire employees. Mr. Colton stated that he devoted 100 percent of his time to the business operation. All of the quarterly New York State and local sales and use tax returns for the period at issue and the checks remitting the sales tax shown to be due on the returns were signed by Mr. Colton as president of Lindenhurst Bagel.

13. On February 20, 2007, the Division issued to petitioner Lindenhurst Bagel & Deli, Inc., a Notice of Determination of sales tax due in the amount of \$83,919.04, plus penalty and interest, for the period September 1, 2003 through May 31, 2006. On the same date, the Division issued to each of the petitioners Dominick A. Forte and James Colton, as persons liable as officers/responsible persons of Lindenhurst Bagel & Deli, Inc., notices of determination of sales tax due in the amount of \$66,596.44, plus penalty and interest, for the period December 1, 2003 through May 31, 2006.

CONCLUSIONS OF LAW

A. The standard for reviewing a sales tax audit where external indices were employed 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 the Lindenhurst Bagel & Deli, Inc.'s sales, as well as the business's failure to produce such books and records for the Division's review. In turn, the auditor reasonably concluded that the business did not maintain books and records that were sufficient to verify its gross and taxable sales for the audit period. Having established the insufficiency of the corporation's books and records, the Division resorted to the use of an observation test to determine the business's sales. The determination of sales tax due on the business's purchases of equipment and leasehold improvements was based upon a review of the corporation's federal depreciation schedule, as the auditor received no documentation which established that tax had been paid on these purchases. The record in this case very clearly bears out that Lindenhurst Bagel neither maintained nor had available any of the necessary and required records pursuant to which the Division could have conducted a detailed audit based thereon. The cash register summary tapes, or Z tapes, do not list specific sales, but are only a summary of the day's activity on the register. Accordingly, the Division's resort to test period and projection auditing to determine tax due was entirely justified and is sustained (*Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138 [1982]).

C. Where the Division has established entitlement to the use of indirect auditing methods, the burden of overcoming the results of such an audit rests upon the taxpayer, who must prove by clear and convincing evidence that the audit method is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451 [1981]; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988) or that the amount of the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113 [1989]). In addressing the method of audit, "[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, 950, 501 NYS2d 219, 221 [1986]). Here, the use of the one-day observation test performed by the Division to determine Lindenhurst Bagel’s gross and taxable sales for the audit period was a methodology well suited to the circumstances, where the corporation failed to maintain adequate source documentation of sales, and is supported by a large body of case law. (See e.g. *Matter of Lombard v. Commr. of Taxation & Fin.*, 197 AD2d 799, 602 NYS2d 972 [1993] [one-day observation test]; *Matter of Club Marakesh v State Tax Commn.*, 151 AD2d 908, 542 NYS2d 881 [1989], *lv denied* 74 NY2d 616, 550 NYS2d 276 [1989] [one-day observation test].) It is not unreasonable to extrapolate the results of a one-day observation test over the entire audit period (*Matter of Del’s Mini Deli, Inc. v. Tax Appeals Tribunal*, 205 AD2d 989, 613 NYS2d 967 [1994]). Petitioners’ submission of cash register summary tapes, or Z tapes, contrasted with the glaring inadequacy of other records, including specifically the absence of original sales records, does not constitute clear and convincing evidence sufficient to demonstrate that the method of audit was unreasonable or that the amount of the assessment was erroneous.

D. 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]).

E. The mere holding of corporate office does not, per se, impose tax liability upon an office holder (see *Vogel v. New York State Dept. of Taxation & Fin.*, 98 Misc 2d 222, 413 NYS2d 862 [1979]; *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*).

F. 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, petitioners James Colton and Dominick A. Forte “were required to establish by clear and convincing evidence that they were not officers having a duty to act on behalf of the corporation, i.e., that they lacked the necessary authority or they had the necessary authority, but were thwarted by others in carrying out their corporate duties through no fault of their own (citations omitted)” (*Matter of Goodfriend*, Tax Appeals Tribunal, January 15, 1998).

G. Petitioners Mr. Colton and Mr. Forte owned 50 percent of the shares of stock of Lindenhurst Bagel for the period at issue. Both individuals participated in making significant business decisions and derived substantial income or had a substantial economic stake in the business. In addition, Mr. Colton and Mr. Forte had the authority to manage the business with knowledge and control over its financial affairs, pay or direct payments of creditors, sign checks in the ordinary course of business, negotiate loans, borrow money for business, guarantee business loans and hire and fire employees. Mr. Colton devoted 100 percent of his time to the business, while Mr. Forte devoted 50 percent of his time to the business operation.

In addition to the above, Mr. Colton was the person responsible for preparing or supervising the preparation of sales tax returns and ensuring the remittance of the tax due. All of the quarterly New York State and local sales and use tax returns for the period at issue and the checks remitting the sales tax shown to be due on the returns were signed by Mr. Colton as president of Lindenhurst Bagel. The foregoing facts indicate that both Mr. Colton and Mr. Forte had broad authority with respect to the management of the corporation and thus indicate responsible officer status. Accordingly, petitioners are persons responsible for the collection and payment of sales tax pursuant to Tax Law §§ 1131 and 1133 and are personally liable for the

sales taxes due on behalf of Lindenhurst Bagel for the period December 1, 2003 through May 31, 2006.

H. The Division asserted penalty herein pursuant to Tax Law § 1145(a)(1)(i) and (vi). Tax Law § 1145(a)(1)(i) states that any person failing to file a return or pay over any sales or use tax “shall” be subject to a penalty. This penalty may be canceled if the failure was “due to reasonable cause and not due to willful neglect” (Tax Law § 1145[a][1][iii]). Consistent with this statute, the Division’s regulations provide that penalty imposed under Tax Law § 1145(a)(1)(i) “must be imposed unless it is shown that such failure was due to reasonable cause and not due to willful neglect” (20 NYCRR 2392.1[a][1]).

Tax Law § 1145(a)(1)(vi) states that any person who omits from the total amount of tax required to be shown on a sales tax return an amount which is in excess of 25 percent of such total amount “shall be subject to a penalty equal to ten percent of the amount of such omission.” Like the penalties imposed under Tax Law § 1145(a)(1)(i), penalties imposed under section 1145(a)(1)(vi) must be sustained unless the failure was due to reasonable cause and not due to willful neglect.

I. Petitioners have not provided evidence or arguments sufficient to constitute reasonable cause or support abatement or cancellation of penalties. In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). Referring to the mandatory language of Tax Law § 1145(a)(1)(i), the Tribunal stated that “the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation” (*Matter of MCI Communications Corp.*, Tax Appeals Tribunal, January 16, 1992). In this case, petitioners neither maintained nor produced records as required, and those records petitioners did

keep were without any source documentation to establish the veracity of the information set forth thereon. Furthermore, Lindenhurst Bagel failed to maintain records relating to its purchase of equipment and leasehold improvements and sales as determined on audit were far in excess of taxable sales reported. Under these circumstances, penalties must be sustained.

J. The petitions of Lindenhurst Bagel & Deli, Inc., James Colton and Dominick A. Forte are denied; and the notices of determination dated February 20, 2007 together with penalties and interest thereon, are sustained.

DATED: Troy, New York
August 20, 2009

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE