STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions of **ROYAL FRIED CHICKEN OF NEW YORK, INCORPORATED D/B/A ROYAL FRIED CHICKEN AND MOHAMMED S. UDDIN** 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, 2004 through May 31, 2007.	:	DETERMINATION DTA NOS. 822557 AND 822601

Petitioners, Royal Fried Chicken of New York, Incorporated, d/b/a Royal Fried Chicken and Mohammed S. Uddin, 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, 2004 through May 31, 2007.

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on September 30, 2009 at 10:30 A.M., with all briefs to be submitted by October 30, 2009, which date began the six-month period for the issuance of this determination. Petitioner Mohammed S. Uddin appeared pro se and on behalf of Royal Fried Chicken. The Division of Taxation appeared by Daniel Smirlock, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUE

Whether the audit methodology was reasonably calculated to determine the amount of sales and use taxes due.

FINDINGS OF FACT

1. Petitioner, Royal Fried Chicken of New York, Incorporated, d/b/a Royal Fried Chicken (the restaurant) was a fast food takeout establishment which sold items such as fried chicken, fish sandwiches, hamburgers, ice cream and barbecued ribs. It did not have any tables or chairs. Petitioner Mohammed S. Uddin was the president of the corporation.

2. On September 6, 2006, prior to the commencement of the audit, the Division of Taxation (Division) sent an investigator to the restaurant for a field visit. He found that the restaurant was 800 square feet with one or more employees. Since October 2002, the restaurant was open from 10:00 A.M. to 10:00 P.M., seven days a week. The investigator also estimated that the gross sales of the store were $700.00 to $800.00 dollars a day and concluded that 100 percent of these sales were taxable. The investigator also determined that the rental of the restaurant cost petitioners $1,000.00 a month plus utilities and taxes.

3. The investigator also ascertained that the restaurant was a quarterly filer for sales tax and that the most recent return filed, at that time, was for the quarter ended May 31, 2006. On this return, the restaurant reported sales of $17,623.00 and a taxable ratio of less than 30 percent. This computed to average daily sales of approximately $195.00. He further noted that the sandwiches were hot and the prices ranged from $4.49 to $5.99. The investigator noted that sales were rung on a cash register but that the restaurant did not use guest checks. On the basis of the forgoing, the investigator recommended an audit.

4. On June 18, 2007, the Division sent a letter to the restaurant stating that its sales and use tax records had been scheduled for a field audit for the period June 1, 2004 through May 31, 2007. 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. Among other things the letter requested sales invoices, cash register tapes and guest checks for the entire audit period.

5. On July 6, 2007, an auditor met with Mr. Uddin at the restaurant. Mr. Uddin provided the auditor with all filed sales tax returns, bank statements, some purchase invoices, the completed sales tax audit questionnaire and an uncompleted responsible person questionnaire. Mr. Uddin completed the questionnaire at the meeting. During the meeting the auditor learned that the landlord reduced his rent from $2,700.00 to $1,970.00 because of the low level of business activity.

6. The auditor concluded that the restaurant's books were inadequate to conduct an audit because they did not have daily totals from cash register tapes, guest checks, a day book, a sales journal or purchase journal from which he could independently determine the restaurant's taxable sales. The auditor decided to use a rent factor of 8.5 percent which he obtained from the Almanac of Business and Industrial Ratios.

7. On September 18, 2007, the Division received some of the rent checks showing the rent expense incurred for the period 2004 through 2007. The Division noted that, from time to time, there was a change in the amount of rent because the level of business varied. Diminishing sales prompted Mr. Uddin to negotiate rent adjustments with the landlord. In order to account for those months where the rent check was missing, the auditor attributed the same rent to subsequent months until he saw another check showing that the rent had changed. The total amount of the estimated rent payments for the period June 1, 2004 August 31, 2005 was $68,890.00.

8. The restaurant filed income tax returns based upon a fiscal year which ended August 31, 2005. The rent deduction reported on the U.S. Corporation Short-Form Income Tax Return

for the fiscal year ending August 31, 2005 was $18,000.00. The rent deductions reported on the federal returns for the fiscal years ended August 31, 2006 and August 31, 2007 were $20,040.00 and $21,242.00, respectively.[1]

9. The 8.5 percent rent factor was obtained from the Almanac of Business and Financial Ratios for the year 2005 for businesses described as food services and drinking places. The Division utilized the column for zero assets because the next column was for assets of less than $500,000.00 and the restaurant's assets were not in that range. The Division also decided to use the highest rent factor which resulted in the lowest amount of tax.

10. In order to calculate the amount of taxable sales, the Division divided the rent of $68,890.00 by the rent factor to calculate audited taxable sales of $810,470.00. This amount was reduced by reported taxable sales of $62,121.00 to find additional taxable sales of $748,349.00. The Division next allocated the additional taxable sales to each sales tax quarter by dividing the amount of additional taxable sales by the reported taxable sales to calculate an error rate of 12.046 percent. For each sales tax quarter, the Division multiplied the error rate by the reported taxable sales. This process resulted in additional taxable sales for the audit period of $748,348.70. The additional taxable sales were multiplied by the sales tax rate in effect for the particular quarter to determine that tax was due in the amount of $63,251.93.

11. On the basis of the forgoing audit, the Division issued a Notice of Determination (Assessment #L-029724281-7), dated February 19, 2008, to the restaurant, which assessed sales and use tax, for the period June 1, 2004 through May 31, 2007, in the amount of $63,251.94[2] plus

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[1] The Division recognized that there was a difference in the rental expense between the tax returns and the analysis of checks but decided to rely upon the analysis of the checks because it did not know if the amounts reported on the federal returns were correct.

[2] At the hearing, the Division acknowledged that the amount of tax assessed should have been $63,251.93.

penalty and interest for a balance due of $108,785.99. The penalty was imposed pursuant to Tax Law § 1145(a)(1)(i) because of the inadequacy of the restaurant's records and the underreporting of tax. The Division also issued a Notice of Determination (Assessment # L-029751018-1), dated February 29, 2008, to Mohammed S. Uddin, which assessed sales and use taxes for the period March 1, 2005 through May 31, 2007 in the amount of $48,535.23 plus penalty and interest for a balance due of $80,238,26.[3]

SUMMARY OF THE PARTIES' POSITIONS

12. At the hearing, Mr. Uddin argued that he requested that the auditor observe the business in order to determine the level of sales. He also argued that new competition came into the area and that, as a result, the restaurant's sales declined substantially. Mr. Uddin also pointed out that he gave the auditor whatever documents he had.

13. Mr. Uddin submits that no one paid him sales tax and that he paid the tax out of his own pocket. According to Mr. Uddin, the restaurant was a very rough neighborhood and that if he tried to collect tax people would have tried to assault him. Mr. Uddin stated that the restaurant operated at a loss but he was hoping that the business would get better. Mr. Uddin borrowed a lot of money and ended up filing for bankruptcy. He is now pennyless and can barely support his family.

14. The Division maintains that it made a request for petitioner's records and correctly concluded that it could not use what was provided. According to the Division, the audit was conducted in a reasonable manner. The Division also submits that although the rent amounts that were utilized do not exactly match the sales tax return amounts, there is an overlap in the periods

[3] The difference in the amount of tax assessed arises from the shorter audit period employed in the assessment issued to Mr, Uddin.

and the two are reasonably close. The Division points out that Mr. Uddin does not contest the assertion that he is responsible for the taxes due from the responsibility. In addition, he has not presented any argument or evidence regarding abatement of the penalty.

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]).

B. Tax Law § 1135(a) provides that "[e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require." Such records include a copy of "each sales slip, invoice receipt, statement or memorandum upon which subdivision (a) of section eleven thirty-two requires that the tax be stated separately." (***Id.***, 20 NYCRR 533.2[b][1])

C. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was 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. . . ." (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select an audit methodology reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the audit methodology or the amount of the assessment was erroneous (***see Matter of Your Own Choice, Inc.,*** Tax Appeals Tribunal, February 20, 2003).

D. 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]) 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).

E. In the present matter, it is clear that the Division made a request for the taxpayer's books and records for the entire audit period and, in response, Mr. Uddin produced sales tax returns, bank statements and some purchase invoices. However, the taxpayer was unable to produce, among other things, cash register tapes, guest checks or sales invoices. Under the circumstances, it was impossible to independently determine through the available records the amount of tax due (***see Matter of Grecian Sq. v. New York State Tax Commn.***, 119 AD2d 948 [3d Dept 1986]). Therefore, it was permissible for the Division to rely upon external indices in order to estimate the amount of tax due and the burden was placed upon petitioners to show that the audit methodology was unreasonable (Tax Law § 1138[a][1]; ***Matter of Sandrich Foods, Inc.***, Tax Appeals Tribunal, September 22, 1994).

F. Petitioners have not satisfied the forgoing burden. Although petitioners offered documents into the record, they have not shown why these documents warrant an adjustment of the assessments. Moreover, petitioners' argument that the Division should have conducted an observation of the business in order to determine liability is rejected. It is well established that "[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. New York State Tax Commn.***). Petitioners have not established that rental factor was inappropriate to the business conducted by the restaurant (***see Matter of A & J Gifts Shop v. Chu,*** 145 AD2d 877 [3d Dept 1988***, lv denied*** 74 NY2d 603 [1989]). It is also noteworthy that the Division entered the chart and sufficient information to identify the source of the chart into evidence ***(Id.***).

G. Before concluding, two points warrant particular attention. First, a vendor is not at liberty to absorb the sales tax (Tax Law § 1132[a][1]; ***Stuyvesant Fuel v. Scola***, 117 Misc 2d 944 [1982]). Second, financial hardship does not excuse the failure to pay sales tax (***Matter of F & W Oldsmobile v. Tax Commn.***, 106 AD2d 792 [3d Dept 1984]).

H. The petitions of Royal Fried Chicken of New York, Incorporated, d/b/a Royal Fried Chicken and Mohammed S. Uddin are denied, and the notices of determination dated February 19, 2008 and February 29, 2008 are sustained together with such penalties and interest as may be lawfully due.

DATED: Troy, New York
April 29, 2010

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE