STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

CHICKEN GOURMET, 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, 2002 through August 31, 2005. :

DETERMINATION
DTA NOS. 822888 AND 822911

In the Matter of the Petition :

of :

EBRAHIM NOORANI :

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, 2004 through August 31, 2005. :

Petitioner Chicken Gourmet, 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, 2002 through August 31, 2005.

Petitioner Ebrahim Noorani 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, 2004 through August 31, 2005.

A 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 April 20, 2010 at 10:30 A.M., with all briefs to be submitted by October 8, 2010, which date began the six-month

period for the issuance of this determination. Petitioners appeared by Rosenberg & Manente, PLLC (David Michael, CPA). The Division of Taxation appeared by Daniel Smirlock, Esq. (Lori P. Antolick, 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 Chicken Gourmet, Inc., (the corporation) was a fast food takeout establishment. Petitioner Ebrahim Noorani was the sole shareholder of the corporation.

2. On September 28, 2005, the Division of Taxation (Division) sent a letter to petitioners stating that the business's sales and use tax records had been scheduled for a field audit for the period September 1, 2002 through August 31, 2005. 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 schedule requested sales invoices, cash register tapes and guest checks for the entire audit period.

3. On February 9, 2006, the auditor met with petitioners' accountant. The accountant presented the auditor with corporation income tax returns and expense purchase records. Not provided was any source documentation such as guest checks or cash register tapes, a day book or any type of tax accrual account.

4. After reviewing the records provided, the auditor decided to employ an indirect audit method to calculate the amount of taxable sales. The indirect audit method chosen was the application of a rent factor.

The auditor determined that during the audit period, the corporation filed U.S. income tax returns for an S corporation (Form 1120S) with a fiscal year ended September 30. On its federal income tax return for the fiscal years ended September 30, 2002, 2003, 2004 and 2005, the corporation reported rent paid in the amounts of $84,442.00, $95,817.00, $129,816.00 and $137,525.00, respectively. As the audit period started in September 2002, the auditor divided $84,442.00 by 12 to arrive at rent paid of $7,036.83 for the month of September 2002. To determine the rent paid for the period October 1, 2004 through August 31, 2005, the auditor divided $137,525.00 by 12 and multiplied the result by 11. The total amount of rent paid by the corporation during the audit period was therefore $358,734.42.

The auditor then referred to the National Restaurant Association Deloitte & Touche 2002 Restaurant Industry Operations Report. He reviewed the statement of income and expenses and its ratio to total sales as related to the limited service restaurant section of the report. Using this statement, the auditor determined that the restaurant occupancy costs, or rent, for the corporation, as reported on its federal income tax returns, fell into the upper quartile category of sales volume under $500,00.00, resulting in a rent factor of 10%. The rent factor was applied to total rent paid during the audit period, resulting in sales for the audit period of $3,587,344.17. The auditor then determined that the first two quarters were 6% of the total sales for the audit period, which equaled $215,240.65 per quarter, or $430,481.30 for both quarters. This figure was subtracted from total sales for the audit period to arrive at sales per the rent factor for the remaining quarters of $3,156,862.87.

Petitioners had reported total sales of $112,449.00 for the audit period, so total additional sales for the audit period less the first two quarters was determined to be $3,044,413.98, with an error rate of 2,707.37%. This error rate was applied to the sales reported for the quarters ended

May 31, 2003 through August 31, 2005, except the quarter ended November 30, 2004. For the quarter September 1, 2004 through November 30, 2004, the auditor had been informed by petitioners that the business was closed for a period of time for health reasons. For that quarter, the auditor gave the corporation a credit of $19,299.40 per week, which amounted to a total reduction in additional sales for that quarter of $231,592.85, and an error rate of 2,499.11%, which was applied to sales reported for this quarter. As a result, the auditor determined additional sales for the entire audit period of $3,455,594.05, and total additional tax due of $295,699.70.

5. Petitioner Chicken Gourmet, Inc., executed five consents extending period of limitations for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law that collectively extended the period in which to assess sales and use taxes due for the period September 1, 2002 through August 31, 2004 to December 20, 2007.

6. On the basis of the audit performed, the Division issued a Notice of Determination (Assessment # L-029435493-9), dated November 15, 2007, to petitioner Chicken Gourmet, Inc., which assessed sales and use tax, for the period September 1, 2002 through August 31, 2005, in the amount of $295,699.69, plus penalty and interest. The penalty was imposed pursuant to Tax Law § 1145(a)(1) because of the inadequacy of the business's records and the amount of the underreporting of tax. The Division also issued a Notice of Determination (Assessment # L-029449064-6), dated November 19, 2007, to Ebrahim Noorani, which assessed sales and use taxes for the period September 1, 2004 through August 31, 2005, in the amount of $153,358.51, plus penalty and interest.

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][A]).

B. Tax Law § 1135(a)(1) 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 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 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 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).

E. In this case, the record establishes the Division's clear and unequivocal written request for books and records of petitioners' sales, as well as petitioners' failure to produce such books and records. The Division reasonably concluded that petitioners 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 methods, including the use of a rent factor, to determine petitioners' 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. Commissioner of Taxation and Finance***, 205 AD2d 989, 613 NYS2d 967 [1994]; ***Matter of Vebole Edibles v. Tax Appeals Tribunal,*** 162 AD2d 765, 557 NYS2d 678 [1990], ***lv denied*** 77 NY2d 803; ***Matter of Sarantopoulos v. Tax Appeals Tribunal***, 186 AD2d

878, 589 NYS2d 102 [1992]) and the use of a rent factor has been specifically addressed and approved (***see Matter of Constantini,*** Tax Appeals Tribunal, January 10, 2008; ***Matter of Your Own Choice, Inc.,*** Tax Appeals Tribunal, February 20, 2003; ***Matter of Bitable on Broadway, Inc.,*** Tax Appeals Tribunal, January 23, 1992, ***confirmed*** 109 AD2d 633 [1993]). In view of the foregoing, the only questions presented in this case are whether petitioners have 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 v. Tully***).

F. Petitioners have not established that the audit method was unreasonable or that the amount of tax determined by application of such method was erroneous. For the period in question, petitioners admittedly did not maintain any record of sales as required by the Tax Law. Petitioners presented no invoices, cash register tapes, guest checks or other source documentation which could be used to establish the correct amount of sales tax due. 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***). Petitioners presented no evidence to show that the rent factor utilized by the Division was unreasonable. Under these circumstances, the Division's resort to a rent factor to determine sales was entirely reasonable (***cf. Matter of Fokos Lounge, Inc.***, Tax Appeals Tribunal, March 7, 1991 [where taxpayer proved through an expert witness that the utilities factor was without a rational basis as applied to its business]). Furthermore, 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***).

G. Petitioners' reliance upon what took place at the conference is misplaced. Conversations taking place during a conciliation conference are in the nature of settlement discussions and have no bearing on the audit conducted or the amount of tax assessed. Therefore, the discussion of what took place at the conference is irrelevant.

H. The petitions of Chicken Gourmet, Inc. and Ebrahim Noorani are denied, and the notices of determination dated November 15, 2007 and November 19, 2007 are sustained together with such penalties and interest as may be lawfully due.

DATED: Troy, New York
March 17, 2011

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE