

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petitions :  
of :  
**A & J GRAND ENTERPRISES, INC.** :  
for Revision of Determinations or for Refund of Sales :  
and Use Taxes under Articles 28 and 29 of the Tax Law :  
for the period March 1, 2005 through February 29, 2008. : DETERMINATION  
822935,  
822936 AND 822937

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In the Matter of the Petition :  
of :  
**YI FENG LIU** :  
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, 2005 through November 30, 2007. :

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Petitioner A & J Grand Enterprises, Inc., 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 March 1, 2005 through February 29, 2008.

Petitioner Yi Feng Liu<sup>1</sup> 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, 2005 through November 30, 2007.

A consolidated hearing was held before Winifred M. Maloney, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, that

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<sup>1</sup> Yi Feng Liu is also known as Andy Liu.

commenced on March 2, 2010 and continued to completion on March 3, 2010, with all briefs submitted by November 26, 2010, which date began the six-month period for issuance of this determination. By letter dated May 3, 2011, this six-month period was extended for an additional three months (Tax Law § 2010[3]). Petitioners, appeared by the Law Offices of Stephen K. Seung (Robert Nizewitz, Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Michael Hall).

### ***ISSUES***

I. Whether the audit methodology utilized by the Division of Taxation in its audit of A & J Grand Enterprises, Inc., had a rational basis and was reasonably calculated to reflect the taxes due.

II. Whether the amount of tax assessed as a result of the application of the methodology used in this case was erroneous.

III. Whether penalties were properly imposed.

### ***FINDINGS OF FACT***

1. During the period at issue, petitioner A & J Grand Enterprises, Inc. (A & J Grand), operated L & L Hawaiian Barbecue, a restaurant franchise, located at 64 Fulton Street, in lower Manhattan, within walking distance of both the World Trade Center site and the South Street Seaport. City Hall and the financial district were also within walking distance of the Fulton Street location. It was the first franchise of its kind in New York City. Open 7 days a week from 10:30 A.M. to 11:00 P.M. on Monday through Friday and 11:00 A.M to 11:00 P.M. on Saturday and Sunday, the 30-seat restaurant served Hawaiian style barbecue cuisine that had a unique Asian flavor. Menu offerings were listed on an overhead menu board and in a paper menu. In

addition to on-premises sales, A & J Grand provided catering and free delivery. Cash and credit cards were accepted during the audit period.

2. Within a block or two of A & J Grand's Fulton Street location, there were a number of fast food and full service restaurants, including, among others, a Burger King located directly across the street, a nearby McDonald's and a Chinese restaurant located right above A & J Grand's location (on the second floor).

3. Since its incorporation on July 8, 2004, petitioner Yi Feng Liu has been A & J Grand's president. Mr. Liu has worked in the restaurant industry for over 20 years. He also owned a restaurant for 10 years prior to opening A & J Grand's restaurant.

4. By contract executed on November 30, 2007, A & J Grand agreed to sell a restaurant located at 64 Fulton Street to Chik Chi Cheng for \$354,000.00. Pursuant to the Rider to Contract of Sale, the contract was contingent upon the franchisor's consent to issue the purchaser a new franchise agreement. The Rider to the Contract also provided that at the closing, the sum of \$20,000.00 was to be held in escrow for sales tax claims from the Division for a period of 45 days. Mr. Liu, as president of A & J Grand, executed this contract.

5. Pursuant to the terms of a bill of sale executed by Mr. Liu, as president of A & J Grand, on January 3, 2008, the corporation, as transferor, in consideration of the sum of \$354,000.00 paid to it, sold, transferred and assigned to the transferee, H & J Restaurant, Inc. (H & J Restaurant), a restaurant located at 64 Fulton Street, New York, New York, "including the open stock in trade only, fixtures, equipment, accounts receivable, contract rights, lease, good will, licenses, rights under any contract for telephone service or other rental, maintenance or use of equipment, machinery and fixtures at the said premises." The terms of the bill of sale also provided, among other things, that the transferor transferred and assigned to the transferee the

existing lease, dated July 20, 2004, “covering premises used in connection with the said business,” together with the security of \$30,000.00 deposited with the landlord, and that the transferor covenanted and agreed not to compete within 10 blocks in all directions for three years.

6. On January 8, 2008, a Notification of Sale, Transfer, or Assignment in Bulk (Form AU-196.10) (bulk sale notification form) was received by the Division’s Sales Tax - Desk Audit section. This bulk sale notification form dated January 3, 2008 from H & J Restaurant provided information concerning the sale by A & J Grand to it of the restaurant located at 64 Fulton Street for a total sales price of \$354,000.00, consisting of tangible personal property (furniture, fixtures, etc.) in the amount of \$20,000.00 and intangible property (goodwill, etc., and covenants not to compete) in the amount of \$334,000.00, as well as the amount of the escrow fund, \$20,000.00. A mailing address and telephone number for the escrow agent, the Law Offices of Henry Lee M. Fong, was listed on the bulk sale notification form. Information provided on the bulk sale notification form also indicated that A & J Grand’s mailing address was care of Henry Lee M. Fong, Esq., and that its last day of business was January 2, 2008.

7. On March 3, 2002, the field audit of A & J Grand was assigned to Joseph Karott, an auditor in the Division’s Manhattan District Office - Sales Tax Section. At that time, Mr. Karott received a folder from the Division’s Albany office, containing a copy of the bulk sale notification form, a copy of the November 30, 2007 contract of sale, and a filled out Robert Morris Statement Study Worksheet, with a one-page attachment. The auditor prepared and printed an appointment letter, dated March 3, 2008, addressed to A & J Grand at the Fulton Street address, which stated that its sales and use tax records for the period March 1, 2005 through February 29, 2008 had been scheduled for a field audit beginning March 17, 2008 at A &

J Grand's office. The letter further advised that all books and records pertaining to A & J Grand's sales and use tax liability for the audit period must be available on the appointment date. It also requested a written response within 10 days confirming the audit appointment scheduled for March 17, 2008. Among the records specifically requested in an attached Records Requested List were the corporation's sales tax returns, worksheets and canceled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; all exemption documents supporting nontaxable sales; chart of accounts; fixed asset purchase/sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips for all accounts; cash receipts journal and sales journal; cash disbursements journal and purchase journal; the corporate books, including minutes, board of directors, articles of incorporation; and depreciation schedules for the entire audit period. Because of the time constraints imposed by Tax Law § 1141(c) on the audit of A & J Grand and the issuance of any assessment against the bulk sale purchaser, the auditor decided to expedite communications with A & J Grand by hand delivering the appointment letter to the Fulton Street restaurant.

8. In addition to printing the audit appointment letter and attachment on March 3, 2008, the auditor also reviewed and printed copies of A & J Grand's sales tax returns on the Division's Image Viewer and placed them in the audit folder. The auditor prepared a schedule of the corporation's sales tax filing history at that time. The auditor found that with the exception of the quarter ending February 28, 2007 for which no sales and use tax return was filed, A & J Grand reported taxable sales on each of the sales and use tax returns filed during the period March 1, 2005 through February 29, 2008. For the period December 1, 2006 through February 28, 2007, the auditor determined that a delinquency assessment was issued by the Division and

tax was paid in the amount of \$2,756.17. He also found that A & J Grand filed its final sales and use tax return on January 18, 2008 and surrendered its sales and use tax Certificate of Authority on that same date. The auditor also reviewed and printed the Application for Registration as a Sales Tax Vendor (Form DTF-17) (vendor registration application) filed by A & J Grand in August 2004. That vendor registration form listed Mr. Liu,<sup>2</sup> as president, and Jialong Xie, as an “officer” of A & J Grand, described the corporation’s business activity as “food service-restaurant,” and listed 722211 as its North American Industry Classification System (NAICS) number.

9. On March 3, 2008, the auditor went to the Fulton Street restaurant premises and found the purchaser’s business there. After identifying himself as a Division employee, the auditor spoke with a Mr. Hui who identified himself as the manager of the new business. In response to questions posed by the auditor during their conversation, Mr. Hui stated that the new business had daily sales of \$1,000.00 to \$1,500.00, wages were paid in cash, invoices were paid by cash and check, and that he did not know the landlord’s name. The auditor did not ask Mr. Hui whether any renovations were made to the business premises by the new business’s corporate owner. The auditor hand delivered the field audit appointment letter to Mr. Hui, who promised to pass it along to Mr. Liu, the owner of A & J Grand.

10. While he was at the Fulton Street restaurant premises on March 3, 2008 at about 4:00 P.M., the auditor conducted a 20-minute field survey of the new business, which was open 7 days a week from 11:00 A.M. to 11:00 P.M. He observed that the business premises had 30 seats, two cash registers, an ATM, a large overhead menu board behind the counter, and an outside sign for

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<sup>2</sup> Mr. Liu’s name was incorrectly listed as Yi Feng Lin on this application. However, Mr. Liu’s social security number was listed on this application.

L & L Hawaiian Barbecue. The auditor also observed that customers placed orders and paid for food by cash or credit cards at the counter and that several of the five employees took orders from and brought food to customers seated at the tables. He found that in addition to the menu board, the customers could order from two different paper menus, one for L & L Hawaiian Barbecue and the other for Time Sushi. He was unable to determine whether the customers were ordering from the L & L Hawaiian Barbecue menu or from the Time Sushi menu, which featured Japanese Sushi cuisine. Because the auditor conducted his survey of the new business between lunch time and dinner time, there were few customers. However, the auditor noted that the new business was located in a busy area. The auditor took paper menus for L & L Hawaiian Barbecue and Time Sushi from the new business. At the hearing, the auditor could not recall if the new name, Time Sushi, was displayed outside.

11. On March 4, 2008, the auditor called the new business and left a message for Mr. Hui.

12. On March 6, 2008, after reviewing the case, the auditor decided to utilize the computations contained in the Robert Morris Statement Study Worksheet, included in the case file sent from Albany, to compute the additional sales tax due for the audit period.

13. The pre-printed Robert Morris Statement Study Worksheet bore the heading "1999/2000 ROBERT MORRIS STATEMENT STUDY WORKSHEET," contained information regarding the annual sales to total assets ratio and the industry taxable ratio for ten different types of businesses, including "restaurants" and "restaurants - fast food," with sales prices from \$0.00 to \$500,000.00, and fill-in formulas to estimate the amount of tax underreported per quarter; the selling price of business assets; and the value of tangible personal property. Lines were drawn through 1999/2000, 1436, the page number referenced for restaurants, and 3.3, the sales to total asset ratio for restaurants, printed on the worksheet, and were replaced with handwritten

notations 2006/2007, 1464, and 3.5, respectively. The formula for estimating the amount of tax underreported per quarter contained the following typed computations. A selling price of \$354,000.00 was multiplied by a sales to total asset ratio of 3.5 to reach estimated annual gross sales of \$1,239,000.00. This estimated annual gross sales amount was divided by four to reach estimated gross sales per quarter of \$309,750.00. Based upon an industry taxable ratio of 100%, estimated taxable sales per quarter of \$309,750.00 were multiplied by the 8.375% tax rate to reach the estimated amount of tax underreported per quarter of \$25,941.56. Page 1464 entitled “RESTAURANT/LODGING-Full-Service Restaurants [NAICS] 722110 (SIC 5812)”<sup>3</sup> was attached to the worksheet when the auditor received the case file. There were two columns of information on page 1464: current data sorted by assets and comparative historical data. In the current data sorted by assets column 0-500M was circled at the top of the page and 3.5 and sales/total assets were circled in the same row near the bottom of the page. The alterations and the computations on the Robert Morris Statement Study Worksheet and the circles on page 1464 were made by an unknown Division employee.

14. The auditor did not refer to the actual source document, the 2006-2007 Annual Statement Studies Financial Ratio Benchmarks, before he adopted the Robert Morris Statement Study Worksheet computations set forth above. Based on those computations, the auditor determined audited yearly taxable sales to be \$1,239,000.00, and after dividing that number by four, determined audited taxable sales to be \$309,750.00 for each of the first eleven quarters of the audit period. For the last quarter of the audit period, because A & J Grand went out of business on January 2, 2008, the auditor computed audited taxable sales for one month only as

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<sup>3</sup> Page 1464 was poorly copied from the 2006-2007 Annual Statement Studies Financial Ratio Benchmarks published by the Risk Management Association (RMA). It appears that the Robert Morris Statement Study was no longer known by that name.

follows. He divided audited quarterly taxable sales of \$309,750.00 by 3 and computed audited taxable sales in the amount of \$103,250.00 for the period December 1, 2007 through February 29, 2008. The auditor determined total audited taxable sales to be \$3,510,500.00 for the period March 1, 2005 through February 29, 2008. Then, the auditor subtracted \$367,497.00,<sup>4</sup> total taxable sales reported for the audit period, from \$3,510,500.00 and determined additional taxable sales to be \$3,143,003.00. After applying the appropriate sales tax rate to additional taxable sales determined, the auditor determined that \$263,901.71 in additional sales tax was due for the period March 1, 2005 through February 29, 2008. The auditor prepared a Schedule of Total Tax Due from A & J Grand for the period March 1, 2005 through February 29, 2008 based upon the above calculations.

15. On March 7, 2008, the auditor sent copies of the March 3, 2008 audit appointment letter on which he had written "Second Request" and "Please contact with [*sic*] this office immediately on receipt of this letter" to Messrs. Liu and Xie at their respective home addresses listed in the vendor registration application filed by A & J Grand in August 2004. Mr. Liu's home address, listed as Fort Lee, New Jersey, on that application, was his ex-wife's home address.

16. On March 12, 2008, the auditor called the new business and spoke with Mr. Hui who claimed to have handed the audit appointment letter over to Mr. Liu.

17. On March 13, 2008, the auditor met with his supervisor, Ronald Chan, and discussed the inadequacy of the corporation's books and records, his field survey of the new business and his earlier computations of additional sales tax due for the audit period. Based on his field

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<sup>4</sup> Based on the corporation's sales tax payment of \$2,756.17 against a delinquency assessment issued for the period December 1, 2006 through February 28, 2007, the auditor computed reported taxable sales of \$32,910.00 for that period.

survey of the new business and his experience as an auditor, it was the auditor's opinion that Mr. Hui had significantly understated the new businesses's daily sales. The auditor estimated the new business's daily sales to be \$3,000.00 to \$4,000.00. Based on his belief that the new business was similar to A & J Grand (i.e., cash business, same location, same franchise name and the same Hawaiian cuisine), the auditor concluded that A & J Grand had significantly underreported its taxable sales for the audit period. Because the auditor's earlier computations of additional sales tax due were based upon computations contained in the Robert Morris Statement Study Worksheet, which used a sales to total asset ratio for a full service restaurant in its computations, the auditor and his supervisor discussed whether the restaurant would be considered a full service restaurant or a fast food restaurant. It was decided that the full service classification should be used based on the auditor's field survey and because that was what A & J Grand classified itself as on its federal income tax returns and corporation franchise tax returns. Based on his discussions with his supervisor regarding the inadequacy of the records, on the field survey, and on his audit experience, the auditor decided to estimate the amount of additional tax due based on external indices, the Robert Morris Statement Study Worksheet included in the file from Albany. Because his March 6, 2008 computations of additional tax due from A & J Grand for the period March 1, 2005 through February 29, 2008 were based upon computations contained in the Robert Morris Statement Study Worksheet, the auditor, on March 13, 2008, printed the previously prepared Schedule of Total Tax Due from A & J Grand for the period March 1, 2005 through February 29, 2008.

18. An entry in A & J Grand's tax field audit record (audit log) indicates that on March 14, 2008, the auditor "[p]rinted [the] Statement of Proposed Audit Changes (AU-346)" and "[p]repared for CARTS upload."

19. The Division issued to A & J Grand a Statement of Proposed Audit Change for Sales and Use Tax dated March 14, 2008, which asserted additional tax due in the amount of \$263,901.70 for the period March 1, 2005 through February 29, 2008, plus penalty and interest.

The following was stated as the basis for the statement:

Since you have not submitted records adequate to prove your liability as required by section 1142 of the Tax Law, tax was determined due in accordance with section 1138 of the Tax Law, using relevant external indices, and is based on a field survey at the place of business.

It further stated that “[i]f you fail to either agree or disagree with this Statement of Proposed Audit Change by 04/14/2008 Form DTF-963, Notice of Determination will be issued.” This statement was addressed to “A & J Grand Enterprises, Inc., L & L Hawaiian Barbecue, 64 Fulton Street, New York, NY 10028.”

20. A subsequent entry in the audit log indicates that Mr. Xie called the auditor on March 14, 2008. During that telephone call, Mr. Xie stated that he sold his share of the business to the Mr. Liu effective January 12, 2006. Mr. Xie faxed a copy of the agreement to the auditor on March 14, 2008.

21. On March 17, 2008, in anticipation of negotiating a settlement at a later date, the auditor sent subpoenas to Citibank and HSBC for records regarding any accounts maintained by, or for the benefit of, A & J Grand and its business.

22. On March 27, 2008, the Division issued a Notice of Determination to A & J Grand, number L-029789244-5, asserting additional sales and use taxes due in the amount of \$255,910.44 for the period March 1, 2005 through November 30, 2007, plus interest in the amount of \$65,877.24 and penalty in the amount of \$88,076.16, for a current amount due of \$409,863.84. On April 14, 2008, the Division issued a Notice of Determination to A & J Grand,

number L-029819933-5, asserting additional sales tax due in the amount of \$7,991.26 for the period December 1, 2007 through February 29, 2008, plus interest in the amount of \$167.21 and penalty in the amount of \$1,678.16, for a current amount due of \$9,836.63. The computation section of these notices stated that:

Since you have not submitted adequate records for audit, as required under sections 1135 and 1142 of the Tax Law, we determined that you owe tax, interest, and any applicable penalties, under sections 1138 and 1145 of the Tax Law, based upon available records and information.

This Notice is one of multiple Notices we either have issued, or will issue, concerning this audit case.

Each Notice of Determination issued to A & J Grand bore the Fort Lee, New Jersey, address.

23. Subsequently, on April 18, 2008, the Division issued a Notice of Determination to Yi Feng Liu at his New York, New York, address, as an officer or responsible person of A & J Grand, for additional sales and use taxes due in the amount of \$255,910.44 for the period March 1, 2005 through November 30, 2007, plus interest in the amount of \$68,603.58 and penalty in the amount of \$88,076.16.

24. A Notice of Determination was also issued to Mr. Xie. However, it was subsequently cancelled by the Bureau of Conciliation and Mediation Services.

25. The record is silent as to whether the Division timely assessed H & J Restaurant as the bulk sale purchaser pursuant to Tax Law § 1141(c).

26. At the hearing, the auditor admitted that he did not expect to find A & J Grand at the Fulton Street restaurant location when he went there on March 3, 2008. He also admitted that he did not know if Mr. Hui actually gave the appointment letter to Mr. Liu.

27. At some point, Mr. Liu received the copy of the March 3, 2003 audit appointment letter bearing the auditor's handwritten notations.

28. At the hearing, Mr. Liu testified that the distinct flavor of the sauce and spices used in Hawaiian barbecue caused much customer dissatisfaction and sales were poor as a result. According to Mr. Liu, the Fulton Street construction projects also had an impact on his sales. Mr. Liu described A & J Grand's business as a fast food, take-out type restaurant that used paper plates, plastic eating utensils and plastic trays to serve food to its customers at the counter.

29. During the period June 1, 2005 through August 31, 2007, A & J Grand paid the corporate franchisor, L & L Franchise, Inc. (L & L Franchise), 1% of its gross sales less sales tax paid on those gross sales.

30. The record includes monthly sales reports submitted to L & L Franchise by Chik Chi Cheng for the 64 Fulton Street location for the months of January 2008 and February 2008. Mr. Cheng reported that the Fulton Street location had gross sales totaling \$13,667.00 and \$16,534.59 in January 2008 and February 2008, respectively. Royalty and advertising fees totaling 4% were paid to L & L Franchise by Mr. Cheng on those monthly gross sales figures less sales tax.

31. New York State Department of State, Division of Corporations, entity information for A & J Grand indicates that its chairman or chief executive officer is Yi Feng Liu, whose address is Fort Lee, New Jersey. The corporation's principal executive office is listed as Yi Feng Liu, Fort Lee, New Jersey.

32. On the federal income tax returns and the corporation franchise tax returns filed by A & J Grand for the fiscal years 2005 (July 1, 2005 through June 30, 2006), 2006 (July 1, 2006 through June 30, 2007) and 2007 (July 1, 2007 through February 29, 2008), the corporation described itself as a restaurant with an NAICS business activity code number of 722210.

33. The record includes the cover, the 10-page section (pages 11 through 21) entitled “Definitions of Ratios, Introduction,” and page 1464 of the 2006-2007 Annual Statement Studies Financial Benchmarks (Annual Statements Studies) published by RMA. The definition section of the Annual Statement Studies contains the following explanation of the sales to total assets ratio:

**How to Calculate:** Divide net sales by total assets.

$$\frac{\text{Net Sales}}{\text{Total Assets}}$$

**How to Interpret:** This ratio is a general measure of a firm’s ability to generate sales in relation to total assets. It should be used only to compare firms within specific industry groups and in conjunction with other operating ratios to determine the effective employment of assets.

The only time a zero will appear in the array will be when the net sales figure is low and the quotient rounds off to zero. The ratio values cannot be negative. They are arrayed from the highest to the lowest positive values.

According to the Annual Statement Studies, for noncontractor balance sheet and income data, net sales is defined as gross sales, net of returns and discounts allowed, if any.

34. Subsequent to the issuance of the notices of determination to A & J Grand, in April 2008, the auditor received bank statements from Citibank and HSBC for a total of four bank accounts, including a personal bank account of Mr. Xie, in reply to his subpoenas. In July 2008, after preparing transcriptions of the deposits from each account’s bank statements, the auditor combined them and computed additional sales tax due based on bank deposits. After the assessment against Mr. Xie was cancelled by BCMS, the auditor prepared a new computation of additional sales tax due based on business deposits in three bank accounts (one Citibank and two HSBC). The auditor determined that deposits into the three business bank accounts totaled \$1,015,441.93 during the period March 1, 2005 through February 29, 2008. After subtracting

\$78,653.83, the sales tax included, from \$1,015,441.93, he computed audited taxable sales in the amount of \$936,788.10 for the period March 1, 2005 through February 29, 2008.

35. Based upon the auditor's analysis of the bank deposits for the Citibank account, the corporation's credit card deposits totaled \$468,560.97 for the period March 1, 2005 through February 29, 2008. During cross-examination, Mr. Liu claimed that the Citibank business account was not A & J Grand's. However, no documentation from Citibank was submitted to support that claim.

### ***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 was not filed, "or if a return when filed was 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 a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of 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. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

C. It is clear from the record that the Division's requests for A & J Grand's books and records were weak and casual. Although the Division received notice of A & J Grand's sale of the Fulton Street restaurant assets to H & J Restaurant on January 8, 2008, the sales tax field audit of A & J Grand was not assigned until March 3, 2008, almost two months later. Keenly aware that the 90-day period for issuance of assessments against A & J Grand and the bulk sales purchaser would expire shortly, the auditor immediately prepared and printed an audit

appointment letter, dated March 3, 2008, that requested all books and records pertaining to A & J Grand's sales and use tax liability for the period March 1, 2005 through February 29, 2008 be available for review at a field audit scheduled for March 17, 2008 at the corporation's office. At that time, he also reviewed and printed the corporation's vendor registration application and its sales and use tax returns for the audit period. Based on that review, the auditor knew the names and addresses of the corporation's officers and that A & J Grand no longer conducted business at the Fulton Street restaurant location. Nevertheless, the auditor, on March 3, 2008, took the appointment letter to the Fulton Street restaurant, where he hand delivered it to Mr. Hui, the manager of the new business, who "promised" to pass it on to Mr. Liu, the owner of A & J Grand. Rather than immediately mailing a copy of the audit appointment letter to Mr. Liu, the auditor called the new business on March 4, 2008 and left a message for Mr. Hui. Neither the auditor's hand delivery of A & J Grand's appointment letter to Mr. Hui, nor the auditor's reliance on Mr. Hui's promise to pass the appointment letter to Mr. Liu, constitutes an explicit request for A & J Grand's books and records for the audit period. The auditor waited until March 7, 2008 to mail copies of the March 3, 2008 appointment letter, on which he had made handwritten notations, to Messrs. Liu and Xie at their respective home addresses listed in the vendor registration application. Exactly six days later, on March 13, 2008, the auditor concluded that a detailed audit of A & J Grand's books and records could not be performed because he had not received any response either confirming the field appointment scheduled for March 17, 2008, or agreeing to supply A & J Grand's books and records for the audit period. At that time, he concluded that the corporation's books and records were inadequate, and resorted to the use of external indices. The Statement of Proposed Audit Change was issued to A & J Grand on March 14, 2008, exactly seven days after the appointment letter requesting the corporation's books and

records was mailed. Subsequently, the Division issued the first Notice of Determination to A & J Grand on March 27, 2008, exactly 24 days after the field audit of A & J Grand was assigned. The urgency of issuing an assessment in order to preserve the liability of the bulk sale purchaser does not justify the Division's weak and casual requests for A & J Grand's books and records (*Matter of Christ Cella, Inc. v. State Tax Commn.*). Clearly, A & J Grand was not afforded a reasonable opportunity to produce its books and records before the Division determined them to be so inadequate to verify A & J Grand's taxable sales and conduct a complete audit from which the exact amount of tax could be determined. Accordingly, it was improper for the Division to resort to the use of external indices for the audit period March 1, 2005 through February 29, 2008.

D. Issues II and III are rendered moot.

E. The petitions of A & J Grand Enterprises, Inc., and Yi Feng Liu are granted; and the notices of determination dated March 27, 2008 and April 14, 2008 issued to A & J Grand Enterprises, Inc., and the Notice of Determination dated April 18, 2008 issued to Yi Feng Liu are cancelled.

DATED: Troy, New York  
August 25, 2011

/w/ Winifred M. Maloney  
ADMINISTRATIVE LAW JUDGE