

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
ZORBA ENDICOTT RESTAURANT CORP., INC.	:	DECISION
D/B/A THE RED LION	:	
	:	
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 December 1, 1976	:	
through December 14, 1979.	:	

Petitioner, Zorba Endicott Restaurant Corp., Inc. d/b/a The Red Lion, c/o Theodosius J. Totolis, 55 Washington Avenue, Endicott, New York 13760, 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 December 1, 1976 through December 14, 1979 (File No. 32135).

A formal hearing was commenced before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, 164 Hawley Street, Binghamton, New York, on January 12, 1984 at 1:15 P.M., continued at the same offices on May 17, 1984 at 1:15 P.M. before Arthur Bray, Hearing Officer, and continued to conclusion at the same offices before Arthur Bray, Hearing Officer, on June 20, 1984 at 12:00 noon, with all briefs to be submitted on or before November 23, 1984. Petitioner appeared by Theodosius J. Totolis, Esq. The Audit Division appeared by John P. Dugan, Esq. (Anna Colello, Esq., of counsel).

ISSUES

I. Whether the Notice of Determination and Demand for Payment of Sales and Use Taxes Due was timely served upon petitioner.

II. Whether the Audit Division properly determined the amount of sales and use taxes assessed against petitioner as the purchaser in bulk of the business assets of a restaurant.

FINDINGS OF FACT

1. On November 30, 1979, the Audit Division received a Notification of Sale, Transfer or Assignment in Bulk notifying the Audit Division that petitioner, Zorba Endicott Restaurant Corp., Inc., was planning to purchase a restaurant from Darbo, Inc. doing business as The Red Lion ("the Restaurant").

2. On December 7, 1979, the Audit Division issued to petitioner a Notice of Claim to Purchaser. The Notice advised petitioner of a possible claim for New York State and local sales and use taxes.

3. On February 26, 1980, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to petitioner assessing sales and use taxes in the amount of \$35,345.39, plus penalty of \$689.27 and interest of \$4,872.07, for a total amount due of \$40,906.73. The Notice advised petitioner that the foregoing taxes were determined to be due from Darbo, Inc. doing business as The Red Lion and represented petitioner's liability as a purchaser in accordance with section 1141(c) of the Tax Law. The Notice also stated that petitioner's payment of \$4,200.00, which had been held in escrow, would be applied to this assessment.

4. On July 12, 1982, petitioner filed a perfected petition alleging, in part, that it had received an untimely assessment by the Audit Division and that the amount assessed by the Audit Division was in error. At the hearing, the petition was supplemented by arguments that all of the Restaurant's records were available and could have been examined, that the audit compared the federal returns which were computed on the accrual accounting method with

purchase records maintained on a cash accounting method based upon the check disbursements journal, that there were errors in the statistical methods used, that there was no test of the number of portions yielded by a given quantity of food, that no consideration was given to the inventory maintained by petitioner, that the seasonal fluctuations of the restaurant should have been taken into account, and that the period of time the restaurant was closed due to a fire was not considered.

5. At the outset of the audit, the Restaurant's sales journal and cash disbursements journal were examined. In addition, the auditor reviewed the Restaurant's federal income tax returns for the years 1977 and 1978, various purchase invoices and guest checks. The Restaurant did not maintain a purchases journal.

6. The Audit Division examined the Restaurant's guest checks for the days August 19, 1977, February 18, 1978 and January 16, 1979 and found that the guest checks were not in proper numerical sequence. The examination revealed that approximately twenty-two percent of the guest checks were missing from the groups of guest checks reviewed. At the hearing, petitioner established that it was the Restaurant's practice to file guest checks on the date when the payment was received and not according to the date the sale was made.

7. The Audit Division also reviewed the Restaurant's check disbursements journal in detail for the entire audit period and compared the amounts found therein with the purchases reported on the federal return. For the year 1977, the Audit Division found that the check disbursements journal disclosed purchases of \$169,978.18 while the federal return reported purchases of \$166,034.00. For the year 1978, the check disbursements journal disclosed purchases of \$166,104.29 while the federal return reported purchases of \$134,696.00.

8. The Audit Division concluded that the Restaurant's records were insufficient because of the number of missing guest checks, the difference between the amounts recorded in the check disbursements journal and the federal returns and the understatement of purchases on the federal returns. As a result, the Audit Division concluded that a markup test on four meals served by the Restaurant was warranted.

9. In order to determine the markup on food, the auditor worked closely with William Farrell Mullen, the president of Darbo, Inc. Because a menu was not provided, the auditor utilized daily summary sheets which listed the items or entrees that were being sold and the prices. With Mr. Mullen's consent, the markup on four dinners was determined using the purchase invoices that corresponded with the selling prices on the daily summary sheets that were reviewed. The food markup that was computed was weighted as to the total amount of purchases for the various entrees. The computations resulted in a food markup of 174.38 percent.

10. In order to determine the total purchases during the audit period, the Audit Division began with the total purchases of \$399,002.13 during the audit period found in the check disbursements journal. The Audit Division then reduced this figure by estimated non-food purchases of \$917.70. The amount was further reduced by \$3,928.01 because of a fire loss. The amount of the fire loss was substantiated by an insurance claim submitted by Mr. Mullen.

11. The Audit Division also reduced the amount of the Restaurant's purchases by \$19,753.71 as an allowance for the loss of food and employee meals. In addition, \$5,629.81, or 1.5 percent of purchases after the above adjustments, was subtracted as an allowance for price discounts for such plans as Dine-A-Mate Club. In order to calculate the amount of the price discount allowance, the

Audit Division reviewed the cash value of Dine-A-Mate tickets for the months of July, August and September of 1979.

12. As a result of the foregoing adjustments, total food purchases for resale were calculated to be \$368,772.90. The markup of 174.38 percent was then multiplied by the food purchases of \$368,772.90 resulting in audited taxable food sales of \$1,011,839.08. The auditor then subtracted the reported food sales of \$705,932.32 resulting in additional taxable sales of \$305,906.76. A margin of error of 43.33 percent was computed by dividing the additional taxable food sales by the reported taxable food sales. The margin of error rate was then multiplied by the taxable food sales and sales tax rate resulting in sales tax due of \$21,411.62.

13. The auditor also conducted an analysis of bar sales. On the basis of this analysis, bar sales were accepted as recorded.

14. The auditor examined the Restaurant's guest checks dated August 19, 1977, February 18, 1978 and January 16, 1979. The examination disclosed that sales tax was being overcollected and not properly remitted. Therefore, the auditor divided the sales tax overcollected by the total restaurant cash receipts for the three day period to derive an overcollection rate of 3.16 percent. The overcollection rate was then multiplied by the total sales tax due resulting in additional sales tax due of \$2,641.24.

15. The auditor reviewed the Restaurant's expense purchases for 1978. A margin of error rate of .83 percent was calculated by dividing the total audited taxable recurring expenses of \$1,386.64 by the Restaurant's gross purchases during 1978. The error rate was then multiplied by the total gross purchases for resale during the audit period resulting in use tax due of \$298.45.

16. In the course of the audit, two repair bills upon which sales tax had been incorrectly computed were discovered. As a result, additional sales and use tax of \$47.23 was found due.

17. The Audit Division assessed use tax due of \$386.11 as a result of the acquisition of capital assets. In addition, the Audit Division assessed sales tax of \$5,562.51 for the period ended November 30, 1979 for failure to remit tax reported due with the return for the period ended November 30, 1979. Lastly, since Darbo, Inc. did not file a sales tax return for the period December 1, 1979 through December 14, 1979, additional sales tax of \$798.23 was computed by applying the Broome County sales tax rate to taxable sales of \$11,403.26 found in the Restaurant's books.

18. In the course of performing the audit, no attempt was made to compare checks against the corresponding invoices. In addition, no adjustment was made for inventory since the Restaurant was about to be sold and, as a result, inventory was not being replenished.

19. On October 22, 1978, the Restaurant suffered fire damage and as a result was closed for a period of seven weeks. During this period, petitioner's records disclosed sales at the bar. However, this was due to people paying past bills. Once the Restaurant reopened, petitioner had less patronage than before the fire.

20. The Restaurant's sales fluctuated during the year. The months of July, August and September were considered "slow" months, while sales were at their greatest during the months of October, November and December.

21. During the period in issue, the Restaurant was having financial difficulty. As a result, the Restaurant was delinquent in paying its bills by as much as two years.

22. It was the practice at the Restaurant that the "late waiter" would place all checks in order and account for all cash. The amounts would then be totalled on a summary sheet. The following day, the bookkeeper would complete the entries with respect to sales that were charged. The bookkeeper would also verify that all entries on the summary sheet were proper. At the end of each month, the records maintained by the bookkeeper would be reviewed by Darbo's accountant.

23. It was the Restaurant's practice to purchase a substantial portion of its inventory at the beginning of each month. As a result, the value of the Restaurant's inventory would decrease during the course of each month.

24. In determining the amount of the markup on food, the Audit Division, in reliance upon information provided by the Restaurant's suppliers, utilized weight measures to determine the number of servings. These weight measures, however, did not take into account the chef's practice of trimming and cutting the meat. In view of these factors, the Restaurant obtained an average of eleven meals from a fourteen to sixteen pound boneless strip steak. Similarly, the Restaurant obtained on the average eleven meals from its purchase of a fifteen to seventeen pound rib eye steak. With respect to the prime and choice tenderloin of beef, there was approximately a forty percent loss in trimming.

25. In determining the cost of the lobster and sirloin dinners, the cost of the lobster tail was based on the purchase of African lobster tail. However, African lobster tail was only available to petitioner about eleven months a year. During one month of the year, petitioner utilized Brazilian lobster tails which were fifteen percent less expensive than African lobster tails.

CONCLUSIONS OF LAW

A. That during the relevant period, section 1141(c) of the Tax Law provided, in part:

"Within ninety days of receipt of the notice of the sale, transfer, or assignment from the purchaser, transferee, or assignee, the tax commission shall give notice to the purchaser, transferee or assignee and to the seller, transferrer or assignor of the total amount of any tax or taxes which the state claims to be due from the seller, transferrer, or assignor to the state, and whenever the tax commission shall fail to give such notice to the purchaser, transferee, or assignee and the seller, transferrer or assignor within ninety days from receipt of notice of the sale, transfer, or assignment, such failure will release the purchaser, transferee or assignee from any further obligation to withhold any sums of money, property or choses in action, or other consideration, which the purchaser, transferee or assignee is required to transfer over to the seller, transferrer or assignor, except that with respect to pending matters such ninety day periods shall not begin to run until ninety days after the effective date of this provision." (Emphasis added.)

B. That section 1147(a)(1) of the Tax Law provides:

"Any notice authorized or required under the provisions of this article may be given by mailing the same to the person for whom it is intended in a postpaid envelope addressed to such person at the address given in the last return filed by him pursuant to the provisions of this article or in any application made by him or, if no return has been filed or application made, then to such address as may be obtainable."

C. That since the Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated February 26, 1980, was mailed within ninety days of the receipt of the notification of the bulk sale, the assessment issued by the Audit Division was timely [Tax Law §§1141(c); 1147(a)(1)].

D. That section 1138(a) of the Tax Law provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined from such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices.

E. That resort to the use of a test period to determine the amount of tax due must be based upon an insufficiency of record keeping which makes it virtually impossible to determine such liability and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Comm., 65 A.D.2d 44). Petitioner did maintain books and records which were available to the Audit Division. These records, however, were insufficient for verification of taxable sales since the guest checks were not filed in a manner which rendered them readily accessible. Moreover, petitioner has not satisfactorily explained the discrepancy between the purchases reflected by its records and the amount of purchases reported on the federal returns. In this regard, there is no evidence that accrual basis records were presented to the Audit Division. Moreover, accrual basis records were not presented at the hearing. Accordingly, the Audit Division properly determined that the use of external indices was proper.

F. That, in determining the amount of a sales tax assessment, it is the duty of the Audit Division to select a method "reasonably calculated to reflect the taxes due" (see Matter of Grant Co. v. Joseph, 2 N.Y.2d 196, 206, cert. den. 355 U.S. 869). When the Audit Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Comm., 61 A.D.2d 223, 227, mot. for lv. to app. den. 44 N.Y.2d 645).

G. That petitioner has established that the markup on food computed by the Audit Division was in error and should be recomputed in accordance with Findings of Fact "24" and "25".

H. That, with the exception of Conclusion of Law "G", petitioner has not established that the amount assessed by the Audit Division was incorrect. In this regard, it is noted that since the margin of error rate was applied to the Restaurant's purchases, both seasonal fluctuations and the period of time the

Restaurant was closed were taken into account. In addition, petitioner has not established that the inventory adjustment for the fire loss, as substantiated by the insurance claim, was in error. Lastly, petitioner has not established that the adjustment for sales discounts was in error. It is noted that exactness is not required when it is petitioner's own failure to maintain proper records which prevents exactness in the determination of sales tax liability (Matter of Markowitz v. State Tax Commission, 54 A.D.2d 1023, aff'd. 44 N.Y.2d 684).


I. That the petition of Zorba Endicott Restaurant Corp., Inc. d/b/a The Red Lion is granted only to the extent of Conclusion of Law "G" and the Audit Division is directed to modify the Notice of Determination and Demand for Payment of Sales and Use Taxes Due accordingly; the petition is, in all other respects, denied and the Notice, as modified, is sustained.


DATED: Albany, New York

STATE TAX COMMISSION

MAY 29 1985


PRESIDENT


COMMISSIONER


COMMISSIONER