

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
STW SALES, 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 December 1, 1975 :
through November 30, 1979. :

In the Matter of the Petition :
of :
JAMES K. WILLMOTT :
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, 1975 :
through November 30, 1979. :

DECISION

In the Matter of the Petition :
of :
DONALD SCHULTZ :
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, 1975 :
through November 30, 1979. :

Petitioners, STW Sales, Inc., 123 North Street, Rochester, New York 14604, James K. Willmott, c/o STW Sales, Inc., 123 North Street, Rochester, New York 14604, and Donald Schultz, 39 Averill Avenue, Rochester, New York 14620, filed petitions for revision of determinations or for refunds of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1975 through November 30, 1979 (File Nos. 32702, 32720 and 32721).

A formal hearing was held before Daniel J. Ranalli, Hearing Officer, at the offices of the State Tax Commission, One Marine Midland Plaza, Rochester, New York, on June 1, 1984 at 9:00 A.M. and continued to conclusion on June 26, 1984 at 12:00 P.M., with all briefs to be submitted by October 1, 1984. Petitioners appeared by John J. Pisaturo, Esq. The Audit Division appeared by John P. Dugan, Esq. (Thomas Sacca, Esq., of counsel).

ISSUE

Whether the Audit Division used proper audit procedures in determining petitioners' sales tax liability.

FINDINGS OF FACT

1. On August 20, 1980, as the result of a field audit, the Audit Division issued two notices of determination and demand for payment of sales and use taxes due against petitioner STW Sales, Inc. ("STW"). The first notice was in the amount of \$29,332.24, plus penalty of \$7,152.19 and interest of \$10,281.85, for a total due of \$46,766.28 for the period December 1, 1975 through May 31, 1979. The second notice was in the amount of \$3,005.31, plus penalty of \$402.42 and interest of \$282.21, for a total due of \$3,689.94 for the period June 1, 1979 through November 30, 1979. On the same date, notices were issued against petitioners James K. Willmott and Donald Schultz in the same amounts and for the same periods.

2. Petitioner STW, by its president, petitioner Donald Schultz, had executed consents extending the period of limitation for assessment of sales and use taxes for the period December 1, 1975 through November 30, 1977 to December 20, 1980. There were no such consents executed by the individual officers.

3. Petitioners Donald Schultz and James Willmott were the officers of STW, which operated a bar known as Jim's Bar ("Jim's") in the city of Rochester. Jim's catered to the "gay" community in Rochester and was the first gay disco in that city. Sometime in 1973, prior to Messrs. Schultz and Willmott assuming ownership, a group of regular patrons began producing female impersonation shows at Jim's. These shows continued after the new owners bought Jim's and have continued to the present time. The shows were staged once or twice a month on Sunday nights. As time went by, the shows became more and more elaborate with the use of expensive costumes, wigs, makeup and stage props.

4. Initially the performers paid for all of their own costumes and props; however, as items became more elaborate and expensive, the performers could no longer afford to buy them. In November, 1978, the performers decided to begin asking for donations of \$1.00 from patrons as they entered the bar. The donations served two purposes: first, they helped pay for the expenses of the show and, second, they helped to keep out curiosity seekers and troublemakers. Initially the collections were taken on Wednesday, Friday and Saturday nights during weeks when a show was scheduled for Sunday. Beginning in August, 1979, the collection was taken at the Sunday night performance only. The amount of the donation requested varied over the years from \$1.00 to \$2.00.

5. Whenever donations were to be collected, one of the performers stood at the entrance along with an employee of Jim's. The employee checked the patrons for proof of age and the performer asked for a donation. Patrons did not have to make a donation and, at times, regular patrons from the "gay" community were not asked for donations. The money collected was placed in a fund taken care of by one of the performers. The money was then dispensed, when necessary, for purchases of costume material, props and other items for

the shows. None of the money was given to petitioners at any time and none of the performers was ever paid for their shows.

6. On audit, the auditor determined that \$12,971.84 in additional sales tax was due on unreported admission charges of \$185,312.00. This figure was arrived at after a personal observation by the auditor of \$1.50 being collected from patrons and from phone calls to the bartender. The auditor assumed that the money being collected was an admission or cover charge and computed total admissions based on an estimate of customers derived from unaudited amounts of beer and liquor purchases.

7. Upon reviewing STW's federal corporation tax returns for the fiscal years ended June 30, 1976, June 30, 1977 and June 30, 1978, the auditor determined that \$56,530.00 in food sales were unreported for sales tax purposes during the period in issue. Such sales resulted in additional sales tax of \$3,957.10. It is unclear from the record how the auditor derived the food sales figure inasmuch as such sales were not separately stated on the federal returns. The auditor did not review any food purchase invoices.

8. The record indicates that, other than for one or two months when petitioners assumed ownership of Jim's, no food was sold at the bar. Prepared foods such as hamburgers, hot dogs or pizza did not sell very well since most of the customers came to Jim's to drink and not to eat. The only food sold on a regular basis during the audit period was bar snacks such as peanuts and potato chips. Purchases of such items never amounted to more than \$25.00 or \$50.00 per week. The reason that food sales were reported in STW's records was that when petitioners first began operating Jim's, they had a restaurant license issued by the Alcohol and Beverage Control Board. Such a license required the establishment to sell food in addition to liquor. Petitioners

feared that they would lose their license to sell liquor if it was discovered that Jim's did not have food for sale; therefore, they took a certain percentage of their beer and liquor sales (usually 10 percent) and reported it as food sales. During 1978, Jim's was no longer required to sell food and the aforesaid practice was discontinued.

9. Based on petitioners' failure to report food sales or admission charges, the auditor determined that the books and records of STW would be inadequate to conduct a complete audit. The auditor conducted a three-month markup test of beer and liquor purchases. The audited markup of 346 percent was then applied to liquor and beer purchases for the period December, 1975 through November, 1978. An error rate of 31.635 percent was computed and then applied to reported taxable sales for the audit period to determine additional sales tax due of \$15,408.61.

10. Jim's utilized two bars with a cash register at each bar. The bartenders rang up all sales under the "bar" category. The register tapes were removed each day, placed in a bag with cash from the register, and sent to the office. Mr. Schultz took the totals from the tapes and transferred them to handwritten sheets which he gave to his accountant for use in preparing tax returns, as well as posting to the books and records. Mr. Schultz retained all of the cash register tapes for the entire audit period; however, the auditor never asked for the tapes and they were not used in conducting the audit. Mr. Schultz also retained the summary sheets which he gave to his accountant and he maintained complete bank deposit records for the entire audit period. Neither of these records was used during the audit.

11. Mr. Schultz emphasized that discrepancies between the audit findings and STW's reported sales could be explained by the amount of free liquor and

beer which was given to employees and performers and also by the amount of beer and liquor stolen during the period. Petitioners allowed all employees to drink for free at all times, whether during working hours or on days off. Jim's employed four bartenders and two waiters. These employees generally drank four to five free drinks per night on their nights off and they were not allowed to drink more than five or six drinks a night while working because the owners wanted to ensure that all the employees remained sober while on the job.

Additionally, Mr. Schultz allowed the performers and their assistants to drink for free on show nights and during afternoon rehearsals. There were usually five to six performers with an equal number of assistants. No limit was placed on the amount of liquor consumed by the performers and, during show weeks, they could consume up to a case of liquor as well as an unspecified quantity of beer.

12. Jim's also employed a disc jockey who was a very popular attraction, but who had a severe drinking problem. The bartenders were instructed not to allow him any liquor; however, the disc jockey would surreptitiously take bottles of liquor and cases of beer and hide them in the ceiling rafters and under the floorboards of the disc jockey booth and also store cases of beer in ice in the toilet tank. The disc jockey would drink as much as a quart of liquor and a case of beer per day.

13. Jim's also employed a porter to receive shipments and carry them upstairs to stock the bar. The porter stored the liquor and beer in a kitchen downstairs and he would leave the door open so that his friends could come in and take cases of beer and liquor out without the owners' knowledge.

14. Petitioners also argued that since the consents extending the period of limitation were signed on behalf of the corporation only and since there

in the instant case maintained all the register tapes for the period, along with other accounting papers with which a complete audit could have been performed. The Audit Division is required to "request the tapes before commencing the markup test, for it is the lack of adequate records that authorizes the use of the test" (Christ Cella, Inc. v. State Tax Commission, 102 A.D.2d 352, 354); therefore, resort to the use of external indices in this case was not warranted and petitioners' sales are accepted as reported.

D. That, in view of the preceding Conclusions of Law, petitioners' argument with respect to the extension of liability to the individual officers is rendered moot; however, it should be pointed out that a consent by a corporation to an extension of the period of limitation "extends the liability of its corporate officers required to collect tax under sections 1131(1) and 1133(a) of the Tax Law for the period consented to by the corporation" (Matter of Corporate Food Services, Inc., State Tax Commission, October 6, 1982).

E. That the petitions of STW Sales, Inc., James K. Willmott and Donald Schultz are granted and the notices of determination and demand for payment of sales and use taxes due issued August 20, 1980 are cancelled.

DATED: Albany, New York

STATE TAX COMMISSION

JAN 18 1985

Roderica W. Chun
PRESIDENT

Francis R. K. Long
COMMISSIONER

Mark J. [Signature]
COMMISSIONER