

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

MICHAEL McSHERRY and ANNE McSHERRY

DECISION

for Redetermination of a Deficiency or for
Refund of New York State Personal Income Tax
and Unincorporated Business Tax under Articles
22 and 23 of the Tax Law and New York City
Personal Income Tax under Chapter 46, Title T
of the Administrative Code of the City of New :
York for the Years 1978 and 1979.

Petitioners, Michael McSherry and Anne McSherry, 331 East 138th Street,
Bronx, New York 10454, filed a petition for redetermination of a deficiency or
for refund of New York State personal income tax and unincorporated business
tax under Articles 22 and 23 of the Tax Law and New York City personal income
tax under Chapter 46, Title T of the Administrative Code of the City of New
York for the years 1978 and 1979 (File No. 36268).

A hearing was held before Allen Caplowaith, Hearing Officer, at the
offices of the State Tax Commission, Two World Trade Center, New York, New
York, on September 11, 1985 at 1:15 P.M. Petitioners appeared by Thomas J.
Joyce, CPA. The Audit Division appeared by John P. Dugan, Esq. (Herbert
Kamrass, Esq., of counsel).

ISSUE

Whether for New York State and New York City personal income tax purposes
and for unincorporated business tax purposes, petitioner Michael McSherry
realized additional, unreported income in 1978 and 1979 as disclosed by a sales
tax field audit.

FINDINGS OF FACT

1. Michael McSherry (hereinafter "petitioner") and his wife, Anne McSherry, filed a New York State Income Tax Resident Return (with City of New York Personal Income Tax) for each of the years 1978 and 1979 under filing status "married filing separately on ~~one~~ return." For each of said years, petitioner reported business income from three (3) taverns totalling \$10,883.98 (1978) and \$4,022.04 (1979).

2. On October 30, 1981, the Audit Division issued a Notice of Deficiency against petitioner and his wife asserting additional New York State personal income tax, unincorporated business tax and New **York** City personal income tax under Article 22 of the Tax Law, Article 23 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, respectively, for the years 1978 and 1979 in the combined amount of \$8,821.84, plus penalty of \$2,069.19 and interest of \$1,609.47, for a total due of \$12,500.50. A Statement of Personal Income Tax Audit Changes and a Statement of Unincorporated Business Tax Audit Changes, previously issued to petitioner and his wife on July 29, 1981, advised them that "additional gross receipts" of \$19,240.00 (1978) and \$19,546.00 (1979), as found upon a sales tax audit, was deemed subject to New York State and City personal income tax and unincorporated business tax. Additionally, for personal income tax purposes, an adjustment was made to a capital loss claimed for each of said years; however, this adjustment was uncontested. Although the aforestated adjustments were attributable solely to the income of petitioner, the Notice of Deficiency was issued against both petitioner and his wife.

3. During the years at issue, petitioner owned three (3) taverns located as follows:

- a) 331 East 138th Street, Bronx, New York 10454;
- b) 1327 Third Avenue, New York, New York 10021;
- c) 523 Third Avenue, New York, New York 10016.

4. All sales by the above three taverns were consolidated on one sales tax return for each sales tax reporting period.

5. The Audit Division conducted an examination of the books and records of petitioner's three taverns for the purpose of verifying taxable sales reported for the period March 1, 1976 through November 30, 1979.

6. Of the three taverns, only the one located at 523 Third Avenue sold food. Because of petitioner's lack of cash register tapes and guest checks, and considering that a prior sales tax audit yielded additional tax due of approximately \$5,000.00, the auditor decided to perform a markup test to measure taxable sales.

7. The sales tax auditor developed markups on wine, liquor and beer through a detailed analysis of purchase bills. According to petitioner's books and records, his food markup was approximately 36 percent. Based on office experience and industry guidelines, the Audit Division decided to apply an estimated markup of 125 percent to petitioner's food purchases after an allowance of 5 percent for employee meals.

8. Based on the markup audit, additional taxable sales were determined to be \$69,683.00, resulting in additional sales tax due of \$5,574.64 for the aforestated periods audited. Petitioner consented to the sales tax deficiency and paid same together with simple interest.

9. After completion of the sales tax audit, an income tax examiner computed the New York State and City personal income tax deficiencies at issue

in this proceeding by treating additional taxable sales revealed by the sales

tax audit of \$19,240.00 for 1978 and \$19,546.00 for 1979 (January 1 through November 30) as additional taxable income realized by petitioner in such years; he **also** treated the additional taxable sales amounts of \$19,240.00 and \$19,546.00 as additional taxable business income in 1978 and 1979, respectively, subject to unincorporated business tax. The deficiencies were thus computed solely with reference to the sales tax examination results, and not by a net worth analysis or an analysis of bank deposits.

10. Petitioner did not personally appear for the hearing. His representative argued that the estimated food markup was overstated; however, no evidence, documentary or otherwise, was presented to establish that the estimated markup was erroneous. He further argued that the markup audit did not constitute a proper basis for asserting the deficiencies at issue herein.

CONCLUSIONS OF LAW

A. That the employment by the Audit Division of a purchase markup analysis to determine additional sales tax due from petitioner was warranted and proper in view of the inadequacy of petitioner's record keeping. While such methodology is commonly used to calculate additional, unreported taxable sales for purposes of Articles 28 and 29, it is also an appropriate means of reconstructing a taxpayer's taxable income, and for purposes of Articles 22 and 23 there is no obligation on the part of the Audit Division to first attempt a net worth or bank deposits analysis. (See DiLando v. Commr., 34 T.C.M. [CCH] 1046; Matter of Carmen and Adelia Garzia, State Tax Corn., June 29, 1983; Matter of William T. Kelly, State Tax Commission, December 31, 1984.) The hearing held herein afforded petitioner a full opportunity to refute the estimated food markup, yet he failed to submit any evidence which would tend to show the audit results were in error.

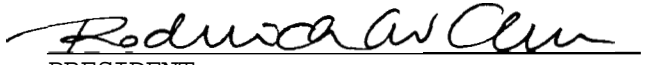
B. That the Notice of Deficiency issued October 30, 1981 is cancelled insofar as it relates to Anne McSherry (see Finding of Fact "2", supra).

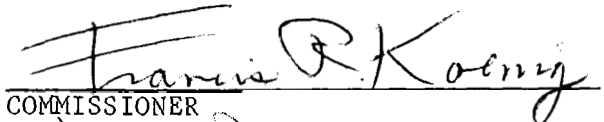
C. That the petition of Michael McSherry and Anne McSherry is denied and, except as provided in Conclusion of Law "B", supra, the Notice of Deficiency issued October 30, 1981 is sustained, together with such additional penalty and interest as may be lawfully owing.

DATED: Albany, New York

STATE TAX COMMISSION

FILE 18700


PRESIDENT


COMMISSIONER


COMMISSIONER