

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition

of

CLUB **MARAKESH**, INC.

DECISION

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 June 1, 1978  
through May 31, 1981.

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Petitioner, Club Marakesh, Inc., P.O. Box 1567, Westhampton Beach, New York 11978, 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 June 1, 1978 through May **31**, 1981 (File No. 36455).

A hearing was commenced before Jean Corigliano, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on January 28, 1986 at 1:15 P.M., continued on June 17, 1986 at 1:15 P.M. and concluded on July 9, 1986 at 11:30 A.M., with all briefs to be submitted by November 3, 1986. Petitioner appeared by Pollner, Mezan, Stolzberg & Frechtman, P.C. (Michael S. Etkin, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Joseph W. Pinto, Esq., of counsel).

~~ISSUE~~

Whether the Audit Division properly determined petitioner's sales tax liability for the period under consideration, by employing estimates based on admissions obtained from third parties.

FINDINGS OF FACT

1. On September 18, 1981, following a field audit, the Audit Division issued to petitioner, Club Marakesh, Inc. a Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing sales and use taxes under

Articles 28 and 29 of the Tax Law for the period June 1, 1978 through May 31, 1981 in the amount of \$121,434.04 plus penalty and interest. On the same date identical notices were issued to the following individuals: Virginia M. Kearns, president of the corporation; Carl B. Johanson, secretary; Edward J. Dougherty, treasurer.

2. Club Marakesh is a discotheque located in Westhampton Beach, New York. During the peak season from the Memorial Day through the Labor Day weekends, Club Marakesh is open five nights a week and employs approximately 15 people: six security persons, four bartenders and five waitresses. The discotheque is multi-leveled and has a dance floor, a bar about 40 feet long, service tables and a patio area with a small service bar. Club Marakesh serves liquor, wine, beer and soft drinks and charges a fee for admission.

3. The auditor began his audit by visiting Club Marakesh in April 1981, at which time the business was closed. In May 1981, the auditor went to Club Marakesh a second time and left a message for ~~Ms~~ Kearns with employees who were present. ~~He~~ received no response. The auditor sent an audit appointment letter to **Ms.** Kearns at Club Marakesh dated July 2, 1981, scheduling an examination of petitioner's books and records for July 16, 1981 and requesting that all books and records pertaining to petitioner's sales tax liability be made available at that time.

4. On July 13, 1981, the auditor received a phone call from a Mr. Scholz who identified himself as petitioner's accountant and requested that the initial audit meeting be held at his offices. At that meeting, held on July 16, **no books** and records were made available. The auditor explained what would be needed to conduct an audit, and a second meeting was scheduled for August 16, 1981. By letter dated August 6, 1981, Mr. Scholz confirmed an earlier phone

conversation canceling the second audit appointment and requesting that it be rescheduled for some time at the end of September. He enclosed a power of attorney executed in his favor by Ms. Kearns, acting for the corporation. On the same date, the auditor sent Mr. Scholz a letter requesting that Club Marakesh's operators maintain detailed records of daily admissions and receipts and execute a power of attorney, a bar fact sheet and a consent to extend the period of limitation for the assessment of sales and use taxes for the period June 1, 1978 through August 31, 1979. The auditor asked that these documents be remitted prior to the meeting which was to be scheduled in late September.

5. The Audit Division determined that it would be necessary to independently observe Club Marakesh's operations and internal controls of records and cash receipts in order to verify its reported sales.

6. On Wednesday night, August 19, 1981, three auditors observed Club Marakesh's premises and Operations between the hours of 9:30 P.M. and 4:00 A.M. Each auditor recorded his observations in memo form. Those observations are summarized below:

a. Two employees were stationed at the entrance: a cashier who collected an admission charge and kept a record of receipts on an adding machine that produced a tape and an individual who kept an exact count of the number of persons entering the club using a hand held counter.

b. The admission charge on that night was \$5.00; however, Wednesday was employees night at Club Marakesh which meant that all employees of hotels, restaurants and other businesses in the Hamptons were admitted free.

c. There was a souvenir table at the entrance selling Club Marakesh tee-shirts, hats and other gift items.

d. Marakesh charged \$2.25 for beer, \$3.00 for regular bar drinks and \$3.25 for premium liquor. Champagne and wine were sold by the bottle.

e. At 11:00 P.M., the three auditors counted 150 people in the discotheque. At 12:00 P.M., they spread out

and each counted a different area. Using this method, they estimated 420 people on the premises. At 3:00 A.M., the auditors decided that the crowd was almost too heavy to count. One auditor noted that the discotheque was filled to capacity. They estimated the crowd at 700 people. At this hour, admissions had tapered down to almost nothing.

7. The memorandum prepared by one of the auditors, Mr. Owsenek, contains the following statements:

"From information obtained verbally it was ascertained that Wednesday is 'Employees Night', wherein employees of all the Hamptons are admitted free of charge. I estimate that between 200 and 250 persons were admitted free.

\* \* \*

From casual discussions with employees of Marakesch [sic], it was ascertained that the disco is closed on Monday and Tuesday, and that estimated persons admitted for the other nights is as follows:

Wednesday	-	750;
Thursday	-	500;
Friday	-	1,000;
Saturday	-	1,200;
Sunday	-	800.

Admission prices charged are: \$5.00 on Wednesday and Thursday, \$15.00 on Friday and \$20.00 on Saturday, and it is believed that \$5.00 is also charged on Sunday."

8. On September 15, 1981 and again on September 16, 1981, an auditor went to Mr. Scholz's offices to obtain the documents previously requested. Mr. Scholz was not present, and no documents were made available. Because it appeared that the requested documents or records would not be made available and because Club Marakesh's peak season had ended, the Audit Division estimated petitioner's tax liability on the basis of the information available to it at that time.

9. That portion of Mr. Owsenek's memo quoted in Finding of Fact "7", provided most of the facts that were used in arriving at an estimate of peti-

tioner's tax liability. The steps taken by the auditor in calculating total audited sales tax due for the audit period were as follows:

a. Weekly admissions charges were estimated as shown:

<u>Day</u>	<u>Admission Charge</u>	<u>No. of People</u>	<u>Admission in Dollars</u>
Wednesday	\$ 5.00	750	\$ 2,500.00*
Thursday	5.00	750**	3,750.00
Friday	15.00	1,000	15,000.00
Saturday	20.00	1,200	24,000.00
Sunday	5.00	<u>750**</u>	<u>3,750.00</u>
Total Weekly		4,450	\$49,000.00

\* In accordance with Mr. Owsenek's memo, 250 free admissions were allowed.

\*\* Mr. Owsenek's figures were adjusted by increasing admissions by 250 on Thursday nights and decreasing admissions for Sunday nights by 50. The reason for the adjustments is not known.

b. Admission charges for the period June 1, 1981 through August 31, 1981 were estimated to be \$637,000.00, by applying the number of weeks in the period (13) to estimated weekly admission charges.

c. To estimate beverage sales, the auditor assumed that each patron purchased two drinks with an average selling price of \$2.75. It was decided to delete from these calculations the 250 persons who were estimated to have been admitted free on Wednesdays. This resulted in a total number of patrons per week of 4,200 and total audited sales per week of \$23,100.00. This figure was multiplied by thirteen to obtain audited beverage sales for the quarter of \$300,300.00.

d. Audited admissions charges and audited sales were combined to obtain total audited sales for the period June 1, 1981 through August 31, 1981 of \$937,300.00. This figure was compared to reported taxable sales for the same quarter in the prior year (a total of \$419,047.00) to calculate an error rate of 123.674 percent.

e. The auditor attempted to apply the error rate to reported sales in each quarter of the audit period; however, he did not have sales tax returns available for the last three quarters. Therefore, he began by estimating reported sales for those quarters. Having first determined that sales reported for the period ended November 30, 1980 represented a 32.7 percent increase in sales over the same period in the prior year, the auditor then estimated reported sales

for the period September 1, 1980 through February 28, 1981 by increasing reported sales for the same quarters in the prior year by 32.7 percent. The auditor determined that sales reported for the period ended May 30, 1980 represented a 61.3 percent increase in reported sales over the same period in the prior year. He then estimated reported sales for the period ended May 31, 1981 by increasing reported sales for the period ended May 31, 1980 by 61.3 percent.

f. Finally, the auditor increased reported taxable sales in each quarter (including the estimated quarters) by 123.674 percent to determine total audited sales for the period of \$3,137,470.00 with a tax due on that amount of \$219,622.90. Tax reported was subtracted from that amount, in order to determine petitioner's remaining tax liability. Apparently, the auditor also estimated the tax that would have been reported for those three quarters where returns were not available and credited petitioners with estimated payments in that quarter. Additional tax due was determined to be \$121,434.04.

10. Following the issuance of the assessment, the Audit Division learned that Club Marakesh was subject to nightly occupancy checks by the Town of Southhampton Department of Fire Prevention. Club Marakesh's maximum legal occupancy in the summer of 1981 was 510. Inspectors checked Club Marakesh several times each evening to insure that it remained within its limits. They sometimes recorded the count of persons taken at the door by a Marakesh employee whose duty it was to control the size of the crowd inside. At other times, the inspectors made an independent estimate of the size of the crowd. On several occasions the cover charge was also noted. Appended to the audit report is a series of inspection reports for most Saturday and Sunday evenings in July and August 1981.

<u>DATE</u>	<u>DAY</u>	<u>TIME</u>	<u>ADMISSIONS</u> <u>PER MARAKESH</u> <u>EMPLOYEE</u>	<u>COMMENTS BY</u> <u>INSPECTORS</u>
July				
6	Monday	2:00 A.M.	743	Cover - \$10.00
11	Saturday	2:05 A.M.	673	Cover - \$10.00
12	Sunday	2:05 A.M.	536	---
19	Sunday	2:16 A.M.	525	Cover - \$20.00
August				
8	Saturday	2:17 A.M.	787	---
9	Sunday	2:01 A.M.	574	Cover - \$10.00
15	Saturday	3:02 A.M.	425	Upper area unoccupied
16	Sunday	1:05 A.M.		500 persons and no line outside
22	Saturday	2:02 A.M.	548	Upper area unoccupied
23	Sunday	1:28 A.M.	532	---
29	Saturday	1:00 A.M.	500	Upper area closed
September				
5	Saturday	2:00 A.M.	674	Crowd estimated at 600 - 650
6	Sunday	1:00 A.M.	594	Crowd, estimated at 600 - 650

11. The records are somewhat confusing in that the exact day of the week cannot be ascertained from the dates given. It appears that the inspectors sometimes noted the change in date that would occur at 12 midnight and sometimes did not.

12. A detailed count of admissions was made by the inspectors on Saturday, July 25, 1981 through the early hours of Sunday, July 26, and disclosed the following:

<u>Time</u>	<u>No. Entering</u> <u>Marakesh</u>	<u>No. Leaving</u> <u>Marakesh</u>	<u>Total</u> <u>Occupancy</u>
10:00 P.M.	40 (employees)	--	40
11:00 P.M.	210	--	--
12:00 P.M.	875	60	815
1:00 A.M.	959	171	788
2:00 A.M.	966	473	493

13. On July 29, 1981, Carl B. Johanson **was** charged with violating a local law by permitting Club Markakesh to exceed its maximum occupancy by 255 patrons on Sunday, July 26, 1981, at 12:45 A.M.

14. From 1978 through the summer of 1980, Club Marakesh's legal occupancy was 434. For the remainder of the audit period, its legal occupancy was 510.

15. The three owners and officers of the corporation divided the duties and responsibilities of running Club Marakesh among themselves. **Ms.** Kearns was primarily responsible for nightly operations, including supervision of admissions and of employees involved with that task. Mr. Johanson was responsible for overseeing the bar and liquor sales, including the purchase of beverages and control of inventory. **Mr.** Dougherty was primarily responsible for installation and operation **of** the discotheque's lighting and sound equipment.

16. A cashier stationed at Club Marakesh's entrance collected the cover charge and maintained a record of 'such charges using an adding machine that produced a tape. **Ms.** Kearns collected money from the cashier at least once and sometimes several times during the course of an evening. There were four cash registers at the bar. **All** beverage sales were recorded on these registers which also produced tapes. Waitresses serving patrons seated at tables utilized guest checks. Twenty checks were issued to each waitress each evening. Unused checks were collected at the end of the evening. The guest checks were not numbered sequentially. At least once every evening, Mr. Johanson totaled the cash registers; collected the cash, the register tapes and the guest checks; and placed the records and money in separate envelopes.

17. The three co-owners met every Monday to reconcile cash receipts with the guest checks, adding machine tapes and register tapes. Total sales receipts for the week were reflected **in** a cash receipts journal as a deposit to cash in



one of two bank accounts maintained by petitioner. Receipts from house accounts (or credit sales) were recorded separately when satisfied. Occasional cash expenses and rental expenses were also recorded in this journal. On busy weekends, reconciliations took place on Friday and Saturday nights, and night deposits of cash were made. Following the Monday reconciliation meetings, all register tapes, adding machine tapes and guest checks were destroyed.

18. It is petitioner's position that its own books and records, made available to the Audit Division after the notice was issued, contain an accurate, complete and verifiable statement of all sales receipts for the audit period. These records include: the cash receipts journal described in Finding of Fact "17"; bank statements and cancelled checks, check registers, cash disbursements journals, purchase invoices, general ledgers, accountant's workpapers, financial statements and State and Federal tax returns. Petitioner retained an accountant who reviewed these books and records subsequent to the Tax Commission hearing and concluded that there was no significant discrepancy between sales as reported by petitioner and sales recorded in its books.

19. For the period February 1, 1977 through February 1, 1980, petitioner leased the premises of Club Marakesh. Under the terms of the lease, petitioner was to pay a maximum rent of not more than 12 1/2 percent of its gross revenues, and it was required to make an annual accounting of such revenues. There was substantial agreement between revenues reported to petitioner's landlord and gross receipts reported on petitioner's sales tax returns.

20. Complimentary free admissions given to members of the press, celebrities, friends of the owners and employees, business associates and others are a standard policy of the discotheque industry, known as a "comp" policy. During

the audit period, an average of 230 people were admitted to Club Marakesh without charge each night.

21. Throughout the audit period, the selling prices of all drinks served at Club Marakesh were inclusive of sales tax, and a sign to that effect was displayed at the bar.

22. **Ms.** Kearns estimated the average number of people admitted to Club Marakesh as follows:

Wednesdays	-	up to 550
Thursdays	-	uP to 300
Fridays	-	up to 500
Saturdays	-	uP to 800
Sundays	-	UP to 450

23. Club Marakesh's cover charge fluctuated with the volume of business. On Wednesday, Thursday and Sunday nights, \$5.00 was charged. On Friday and Saturday night, the cover charge ranged from \$10.00 to \$20.00, depending on the size of the crowd.

23. Petitioner reported the following taxable sales for the last three quarters of the audit period: September 1, 1980 to November 30, 1980 - \$88,648.00; December 1, 1980 to February 28, 1981 - \$19,478.00; March 1, 1981 to May 31, 1981 - \$60,003.00.

24. It is the petitioner's contention that the audit methodology was flawed in that: (1) the estimate of admissions was based upon unreliable heresay information provided by unidentified employees; (2) the error rate was calculated by comparing audited sales for the quarter ended August 31, 1981 with reported sales for the same period in the prior year, thus failing to take

into account increases in reported sales over the prior year<sup>1</sup>; and (3) the application of an error rate calculated with reference to petitioner's busiest quarter to all other quarters failed to take into account the fluctuating nature of petitioner's business.

#### CONCLUSIONS OF LAW

A. That Tax Caw § 1135(a) imposes on every person required to collect tax the duty to maintain records of every sale and the tax payable thereon. Petitioner's position that its cash receipts journal was an adequate record of sales is untenable, since the journal did not necessarily portray true sales and must itself be subject to verification. Furthermore, petitioner's officers admitted destroying the source documents essential to verify sales recorded in the cash receipts journal.

B. That where adequate records of sales are not maintained or are not furnished, the Audit Division may rely upon such information as it has available to estimate taxes due (**Tax** Caw § 1138[a]). The Audit Division has a duty to select an audit method reasonably calculated to reflect the taxes due; however, exactness **is** not required where the party's **own** failure to maintain proper records prevents it (Matter of Korba v. New York State Tax Commn., 84 AD2d 655, 656). In the absence of other information, the Audit Division was justified in estimating tax due on the basis of information solicited from petitioner's employees and from the independent observations of three auditors. However,

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1 The record does not disclose whether petitioner timely filed returns for the period ended August 31, 1981, and if it did the amount of taxable **sales** reported.

certain of the Audit Division's findings are inconsistent with facts adduced at hearing. The starting point for estimating petitioner's taxable sales was information regarding admissions obtained informally from petitioner's employees. The record discloses **no** reason for increasing the employees' estimates of Thursday night admissions by 250 or decreasing Sunday night admissions by **50**. **In** contrast, it **is** reasonable to conclude that the actual count of individuals admitted to Club Marakesh **on** the night of July **25**, 1981 and the early morning hours **of** July **26**, 1981, conducted by the Department of Fire Prevention, **is** the most accurate figure available from which **to** estimate Saturday admissions. **In** light of **Ms.** Kearns admission that petitioner's principals destroyed the records necessary to verify her testimony regarding nightly admission, that testimony **is** not deemed to be credible. Accordingly, total admissions for the audit period are **to be** determined using the following figures: Wednesdays - **750**; Thursdays - 500; Fridays - 1,000; Saturdays - **966**; Sundays - 800.


C. That petitioner established that the following adjustments to the audit procedure are appropriate: (1) the Saturday night cover charge **is** to be reduced to \$15.00; (2) the average selling price of a drink **is to** be decreased to reflect the inclusion therein of the sales tax; (3) the admissions per evening as estimated in Conclusion of Law "B" are to be reduced by 230 to reflect petitioner's "comp" policy, and the results are to be used to determine audited admission sales for the period; (4) the error rate **is** to be calculated with reference to these adjustments and applied to sales as reported by petitioners in all quarters **of** the audit period. Because the record does **not** disclose the amount of petitioner's reported taxable sales for the quarter ended August 31, 1981, the error rate must be calculated by comparing audited sales for that quarter with reported sales for the same quarter **in** the prior year.


D. That the petition of Club Marakesh, Inc. is granted to the extent indicated in Conclusions of Law "B" and "C"; that the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued on September 18, 1981 shall be modified accordingly; and that, in all other respects, the petition is denied.

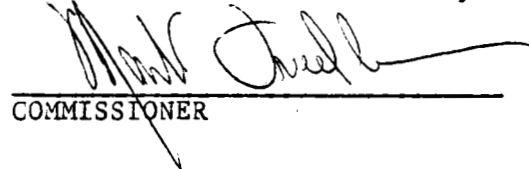
DATED: Albany, New York

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