

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :

of :

HAROLD A. WEISS  
D/B/A EXECUTIVE RESTAURANT :

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 March 31, 1981. :

Petitioner, Harold Weiss d/b/a Executive Restaurant, 39 Phila Street, Saratoga Springs, New York 12866, 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 March 31, 1981 (File No. 36529).

A small claims hearing was commenced before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Building #9, State Office Campus, Albany, New York, on October 17, 1983 at 1:15 P.M. and was continued to conclusion before the same Hearing Officer at the same location on May 9, 1984 at 9:15 A.M., with all documents to be submitted by August 28, 1984. Petitioner appeared by Carley P. Byrne, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (James Della Porta, Esq., of counsel).

ISSUE

Whether petitioner has substantiated the claim that certain deposits to his business bank accounts, which were treated by the Audit Division as business receipts subject to sales tax, were in fact receipts from sources not subject to sales tax.

FINDINGS OF FACT

1. On September 16, 1981, the Audit Division issued to petitioner, Harold A. Weiss d/b/a Executive Restaurant, a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the quarterly period spanning the period June 1, 1978 through August 31, 1978, in the amount of \$5,000.00, plus penalty and interest. This assessment was estimated and was subsequently reduced, upon the basis of actual audit work, to \$781.90, plus penalty and interest.
2. On November 24, 1981, the Audit Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the quarterly periods spanning September 1, 1978 through May 31, 1981 in the amount of \$8,824.92, plus penalty and interest.
3. The total assessed by the aforementioned two notices, after reduction of the September 16, 1981 notice, as described, is \$9,606.82, plus penalty and interest.
4. Petitioner operates, as a sole proprietorship, the Executive Restaurant ("the business"), a bar and restaurant located in Saratoga Springs, New York.
5. In or about May, 1981, the Audit Division commenced an audit of petitioner. Upon comparison of petitioner's sales tax returns with his 1980 Federal Income Tax Return, it was discovered that gross sales reported for 1980 (approximately \$22,507.00) and for the entire audit period (\$72,845.00), per petitioner's sales tax returns, were less than by gross receipts reported per his 1980 income tax return alone (\$73,720.40). A review of petitioner's books and records revealed gaps in reported daily receipts (i.e. no sales listed for several dates). Some of these gaps reflected notations that the business was closed, while other gaps had no explanations. A review of purchase invoices for a six month period based on checks written by petitioner led the auditors to the

conclusion that not all purchase invoices were available and accounted for. In view of these discoveries, the auditors were unable to determine the origin of petitioner's sales and concluded that petitioner's books and records were incomplete and inadequate.

6. In view of the foregoing, the auditors decided to check the accuracy of petitioner's reported sales by performing an audit based on bank deposits, the results of which are summarized below.

a) Deposits to petitioner's two business bank accounts totalled \$210,250.75 for the audit period.<sup>1</sup> This total was increased by estimated family living expenses of \$200.00 per week (\$10,400.00), to arrive at \$220,650.75.

b) The auditors assumed that the deposits included sales tax collected and, after reducing such deposits by applying the sales tax rates in effect during the period (6 percent through August, 1980; 7 percent thereafter), arrived at a sales tax liability of \$14,285.21.

c) After allowing credit for sales tax remitted of \$4,677.13 against the audited sales liability (\$14,285.21), an error rate of 205.4 percent resulted, which was applied to sales tax reported per quarter to arrive at the assessed liability of \$9,606.82.

7. The auditors noted no significant lump sum deposits to petitioner's bank accounts, a factor they felt militated against petitioner's explanation that deposits were due, in large part, to loans. Finally, the auditors examined petitioner's recurring purchases and capital expenditures in detail for the audit period and found no tax due in these areas.

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<sup>1</sup> Deposits for the first quarterly period and for the last month of the audit period were estimated based on average deposits per quarter over the remainder of the audit period, due to the unavailability of deposit records for such two periods.

8. Petitioner maintains his own records, although his tax returns are prepared therefrom by an independent bookkeeper. Petitioner testified that contrary to the auditors' assumptions, not all deposits were the result of receipts from operating his bar and restaurant, but were largely due to loans received from various sources and other receipts from activities not subject to sales tax.

9. Petitioner testified that almost all of his business is generated by students from Skidmore College during Skidmore's approximately nine month academic year and by an increase in business during the August thoroughbred racing session. The business is closed during June, part of December and on every Monday. The business also was closed on several other days, as reflected by petitioner's testimony and by notations for certain days on the ledger sheets submitted, due to a lack of business and/or personal reasons.

10. Petitioner testified that the excess of receipts on his 1980 income tax return over the receipts reflected on his sales tax returns was due to loans received and other items of income from sources not subject to sales tax. Petitioner testified that he only reflected and reported as subject to sales tax (on his sales tax returns) receipts from the business, but that he reflected these business receipts plus all other items of "income" on his income tax return. These other items of "income" reflected on petitioner's income tax return included certain loans from third parties and/or family members, which petitioner (and apparently his bookkeeper) believed were properly includable as taxable income, plus certain other items not subject to sales taxation, as follows:

<u>ITEM</u>	<u>DATE</u>	<u>AMOUNT</u>
a) loan; from Six Point Club	January 31, 1979	\$ 9,950.00 (net)
loan; from Six Point Club	September 17, 1980	19,800.00 (net)
loan; to petitioner's wife through Adirondack Trust Co.	June 24, 1981	1,800.00
loan; mortgage loan on personal residence through State Bank of Albany	June 24, 1981	15,000.00
b) rental income from an apartment located above petitioner's personal residence	Throughout entire audit period (\$200.00 per month)	\$ 6,600.00 (33 months at \$200.00 per month)

c) Receipts from commissions on a juke box and cigarette machine, and receipts from a pool table and three video games owned by petitioner amounting to "at least \$1,000.00 per month".

d) Loans from petitioner's father, later forgiven as debts owed by petitioner, whenever petitioner needed money. Petitioner testified to a loan of \$12,000.00, and probably more, in 1980, and other loans at other times.

e) Blue Cross/Blue Shield payments consisting of accumulated amounts of premiums due from petitioner's family members paid to petitioner, deposited to the business checking account and paid out by petitioner in one check to enable those involved to obtain a group rate plan from Blue Cross/Blue Shield. Blue Cross/Blue Shield wanted one check rather than separate checks from each group member. Petitioner accommodated this situation by accumulating the individual checks and writing one check. For 1980, petitioner paid \$2,741.76 to Blue Cross/Blue Shield by one check out of his business checking account on October 16, 1980. Petitioner testified that in other years, the Blue Cross/Blue Shield payments might have been handled through his wife's separate checking account.

11. Petitioner testified that he did not deposit large amounts of the loan proceeds in his bank accounts because he "...doesn't like banks". Rather, petitioner testified that he kept the proceeds of the loans at home in cash and used them as needed in the business. Petitioner specified that the \$10,000.00 Six Point Club loan was used to remodel the dining area of the restaurant. Petitioner testified that he used part of the loan proceeds to make cash payments as needed and also deposited some of the loan proceeds in varying amounts and then wrote checks as needed in the business.

12. Petitioner submitted in evidence a total of twenty deposit slips to the business account at Adirondack Trust Company. Petitioner testified, and these deposit slips reflect, that when he deposited, he put a handwritten notation of "loan", "bank", or "book" on the deposit slip to identify the portion of the deposit which represented proceeds from the various loans. Petitioner did this for his own records so he would know what portion of a given deposit to an account consisted of loan proceeds and what portion of a deposit represented business receipts subject to sales tax. Petitioner testified that he wanted to be able to show that not all items deposited in the accounts were from the restaurant.

13. A numerical presentation of the twenty deposit tickets which, under the method explained above, reflected deposits of loan proceeds (and in one case "commissions", presumably from the cigarette machine and/or juke box), is as follows:

<u>DATE</u>	<u>AMOUNT</u>
1/18/80	\$ 185.00
1/28/80	2,000.00
2/01/80	448.00
3/09/80 ("commission")	400.00
8/05/80	800.00
8/18/80	650.00
8/19/80	400.00
8/25/80	1,800.00
9/10/80	1,900.00
9/15/80	500.00
9/21/80	1,096.00
9/29/80	500.00
10/15/80	1,000.00
10/21/80	2,190.00
10/23/80	2,000.00
11/01/80	1,010.00
11/06/80	150.00
11/08/80	200.00
11/10/80	640.00
12/20/80	2,500.00
Total	<u>\$20,369.00</u>

14. Petitioner also submitted evidence substantiating the noted loans from the Six Point Club, through his wife, and from the mortgage on his personal residence (see Finding of Fact "11-a"), as well as a few checks reflecting, in conjunction with petitioner's ledger, repayments made thereon. Petitioner also presented a copy of a check for the \$2,741.76 Blue Cross/Blue Shield payment described in Finding of Fact "11-e".

15. Petitioner testified that he used the receipts from his pool table and video games, and the juke box and cigarette machine commissions, to pay expenses in cash on an ongoing basis. Sample receipts for commissions were presented as follows:

<u>DATE</u>	<u>AMOUNT</u>
1/30/79	\$ 44.00
5/31/79	52.00
6/22/79	25.00
8/10/79	36.00
3/14/80	35.00
5/09/80	20.00
9/19/80	35.00
Total	<u>\$247.00</u>

16. Petitioner testified to loans from his father, later forgiven as debts, occurring as needed. A passbook savings certificate account with Schenectady Savings Bank, opened on April 1, 1980 in the amount of \$15,000.00 and withdrawn on September 30, 1980, bore a handwritten notation "Allen for Rest." and allegedly represented a loan from petitioner's father. Petitioner testified that he was not sure of the total amount loaned to him by his father during the period in issue, but noted that his "father would have a record of it".

17. Although petitioner asserted there were interbank transfers which could account for many of the deposits treated by the auditors as taxable receipts, no evidence of such interbank transfers was presented.

18. Petitioner asserts that the bank deposits audit gave no cognizance to deposit sources other than receipts from the business, including deposits from loan proceeds, vending receipts or rental income receipts. Petitioner notes that such receipts explain the discrepancy between the amounts per sales tax returns and petitioner's 1980 income tax return, the latter of which included (due to petitioner's apparent misimpression) the loan proceeds as taxable income. Finally, petitioner asserts his business could not have generated the amount of sales attributed to it as reflected by the instant audit results.

CONCLUSIONS OF LAW

A. That a "...vendor is obligated to maintain records of his sales for audit purposes (Tax Law, §1135), and the State, when conducting an audit, must determine the amount of tax due 'from such information as may be available,' but 'if necessary, the tax may be estimated on the basis of external indices' (Tax Law, §1138, subd. [a])." Matter of George Korba v. New York State Tax Comm., et al., 84 A.D.2d 655.

B. That given the various irregularities noted in petitioner's records, including the discrepancies between the total sales per sales tax returns versus the gross receipts per the 1980 income tax return, the lack of complete purchase invoices, and the gaps in receipts on petitioner's ledger sheets, the Audit Division was justified in resorting to external indices as a means of determining petitioner's tax liability (Matter of Korba, supra.). In fact, petitioner has not contested the Audit Division's assertion that resort to external indices (i.e. business bank deposits analysis) was warranted. Petitioner asserts, rather, that proper credit was not given for amounts the auditor included in deposits as subject to sales tax which amounts were not properly so



subject, and that the sales tax liability as assessed by the Audit Division was overstated.

C. That petitioner's testimony indicated payments made both in cash and by check. The receipts from the video games, pool table, juke box and cigarette machine were, according to testimony, rolled over into the business on a cash basis. Loan proceeds were gradually put into the business as needed. No mention was made of how the rental income was handled (i.e. whether it was deposited into the business bank accounts or kept at home and used by petitioner). With regard to explaining the excess deposits to the business bank accounts, petitioner substantiated (by deposit slips and testimony in conjunction therewith), cash deposits from sources not subject to sales tax in the amounts of \$20,369.00 (see Finding of Fact "14") and \$2,741.76 (pertaining to Blue Cross/Blue Shield; see Finding of Fact "10-e"). However, although petitioner has substantiated the existence of loans, rental income, and bar games receipts, as described, which items were not subject to sales tax (and in the case of loans, not subject to income taxation) and thus has narrowed the gap between amounts reported as receipts on sales tax returns versus such amounts reported as gross receipts on the 1980 income tax returns, petitioner has not proven that these items which were not subject to sales tax were deposited into the business bank accounts analyzed. Even assuming all items asserted were so deposited in the business accounts (in effect, ignoring cash payouts acknowledged to have been made), the total of these items, together with total sales receipts reported (\$72,845.00), still falls far short of deposits made (\$210,250.75). Furthermore, two of the loans described were made after the audit period and could not have resulted in deposits to the bank accounts during such period.<sup>2</sup> In sum, petitioner

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<sup>2</sup> The audit period ended on March 31, 1981, while the \$1,800.00 Adirondack Trust Loan and the \$15,000.00 State Bank of Albany mortgage loan (see Finding of Fact "10-a") were not made until June 24, 1981.

has failed to establish that amounts deposited, except those items noted herein (\$20,369.00 plus \$2,741.76), were from sources other than from operation of the restaurant. Accordingly, except to the extent that deposits subject to tax should be reduced to reflect the aforementioned items (totalling \$23,110.76), the assessment as issued is sustained.

D. That the petition of Harold A. Weiss d/b/a Executive Restaurant is granted to the extent indicated in Conclusion of Law "C", but is in all other respects denied and the notices of determination and demands for payment of sales and use taxes due dated September 16, 1981 (as reduced in accordance with Finding of Fact "1") and November 24, 1981, respectively, and as recomputed in accordance herewith, are sustained.

DATED: Albany, New York

FEB 20 1985

STATE TAX COMMISSION

*Rodnicka W. Olen*  
PRESIDENT

*Francis R. K. Olen*  
COMMISSIONER

*[Signature]*  
COMMISSIONER