

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
MORTON SAIPE, : DECISION
OFFICER OF 339 MERRICK ROAD RESTAURANT, 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 March 1, 1979 :
through December 10, 1981. :

Petitioner, Morton Saipe, officer of 339 Merrick Road Restaurant, Inc., 6 Gault Park Drive, Westport, Connecticut 06880, 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 March 1, 1979 through December 10, 1981 (File No. 37654).

A formal hearing was held before Frank A. Landers, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 1, 1984 at 2:45 p.m. with all briefs to be submitted by January 14, 1985. Petitioner appeared by James O. Druker, Esq. The Audit Division appeared by John P. Dugan, Esq. (Irwin A. Levy, Esq., of counsel).

ISSUE

Whether the Audit Division properly determined additional sales and use taxes due from 339 Merrick Road Restaurant, Inc. for the period March 1, 1979 through December 10, 1981.

FINDINGS OF FACT

1. On May 4, 1982, the Audit Division, as the result of a field audit, issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due under Articles 28 and 29 of the Tax Law against 339 Merrick Road Restaurant,

Inc., d/b/a Scotty's Restaurant for taxes due of \$70,508.80, plus interest of \$12,673.52, for a total amount due of \$83,182.32, for the period March 1, 1979 through December 10, 1981.

On the same date, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner, Morton Saipe, for taxes due of \$69,466.77, plus interest of \$12,673.52, for a total amount due of \$81,906.72 for the period March 1, 1979 through December 10, 1981. The assessment against petitioner was based on the fact that he was an officer of 339 Merrick Road Restaurant, Inc.

2. It is the position of the Audit Division that since 339 Merrick Road Restaurant, Inc. ("the corporation") d/b/a Scotty's Restaurant did not use cash register tapes, then the books and records maintained by the corporation were insufficient for determining taxable sales and necessitated the use of external indices.

3. The petitioner claims that the examiner's use of estimates under the circumstances of this case was arbitrary and capricious and, therefore, the audit lacked a rational basis and must be annulled. Pursuant to his perfected petition filed on June 4, 1984, the petitioner claims that the examiner ignored the corporation's practice of free pouring liquor into glasses in which it was served and, with respect to food sales, the petitioner claims that the examiner ignored the fact the corporation's portions served were very generous and would generate a smaller markup than might be considered normal in restaurant operations. The petitioner also claims that the use tax was based upon an improper evaluation of certain improvements placed in service by the corporation.

4. The corporation operated Scotty's Restaurant, a family-style restaurant located in Rockville Centre, New York. From 1972 to 1979 the petitioner, Morton Saipe, a financial backer and one of several shareholders of the corporation, visited the restaurant about once a week and spent the day. Petitioner became actively involved in the corporation in 1979 when his partner left. Petitioner was in charge of the day to day management and running of the restaurant until it was sold on December 10, 1981.

5. In or about March 1982, the examiner was furnished with the books and records of the corporation. Since the corporation did not use cash register tapes, there was nothing against which to match the guest checks. Therefore, the examiner used a test period audit method combining both the records made available and external indices. The examiner also used a "bar questionnaire sheet" which the petitioner completed.

Analysis of the Federal Income Tax returns for the years ended April 30, 1980 and April 30, 1981 revealed overall markups of 105% and 92% respectively. Separate markups per the books were computed for food and liquor (including beer & soda). These computations revealed a book markup on food of 80.8% and a book markup on liquor of 202.2%. Based on office experience, the markups were considered too low and an indication that all sales were not recorded on the taxpayer's books.

Based on office experience, a tour of the restaurant, and prices reflected by the guest checks (menus were not made available to the examiner), the examiner used a 175% markup on food. This markup, when applied to food purchases (after inventory adjustment and allowance for employee meals), resulted in audited food sales of \$2,397,367.91.

An analysis of liquor invoices was done for the test month September 1981. The markup on liquor was computed to be 365.3% (after allowance for spillage) based on the bar questionnaire sheet filled out by petitioner, prices obtained by a review of the guest checks, and office experience. This markup, when applied to liquor purchases (after adjustment for inventory), resulted in audited liquor sales of \$319,271.46.

An analysis of beer invoices was done for the test months September and October 1981. The markup on beer was computed to be 262.22% (after allowance for spillage) based on the bar questionnaire sheet, prices obtained by a review of the guest checks, and office experience. This markup, when applied to beer purchases (after adjustment for inventory), resulted in audited beer sales of \$27,851.93.

An analysis of soda invoices was done for the test months September and October 1981. The markup on soda was computed to be 745.93% (after allowance for spillage) based on prices obtained by a review of the guest checks and also on information obtained from the corporation's main supplier. This markup, when applied to soda purchases (after inventory adjustment and allowance for employees' consumption) resulted in audited soda sales of \$53,459.39.

For the period at issue, audited gross and taxable sales amounted to \$2,797,950.69. The corporation reported taxable sales of \$1,856,610.00 which resulted in additional taxable sales of \$941,340.69 and additional taxes due thereon of \$66,071.38.

6. In addition, an overcollection test was done on guest checks from October 13, 1981 through October 18, 1981. The test revealed an overcollection rate of 1.29% which when applied to audited sales tax due resulted in additional sales tax due of \$2,533.35.

A review of additions to the fixed asset account revealed additional purchases subject to use tax of \$14,886.13 and additional use tax due of \$1,042.03.

Based on the books and records provided, the examiner could not find substantiation for the \$10,000.00 sales price of the assets shown on the Notification of Bulk Sale. Review of the latest Federal Income Tax return (4/30/81) revealed that fixed assets had a book value of \$20,490.22. The examiner used the book value as the sales price of the assets transferred. In addition, per review of the adjustments to the Closing Statement, there was an additional charge of \$1,400.00 for "Rockwell" prints. Therefore, the total amount subject to bulk sales tax was determined to be \$11,890.22 (\$20,490.22 + \$1,400.00 - \$10,000.00) with a bulk sales tax due thereon of \$862.04.

7. As a result of the aforementioned audit, the following additional taxes were determined to be due:

<u>Category</u>	<u>Amount</u>
Sales tax from business operations	\$66,071.38
Sales tax due from overcollections	2,533.35
Use tax due on fixed assets	1,042.03
Bulk sales tax due	862.04
TOTAL	<u>\$70,508.80</u>

The Audit Division issued Notices of Determination in the above amount against the purchaser, Scotty's Restaurant Corp., and the seller, 339 Merrick Road Restaurant, Inc. The aforementioned Notice (Finding of Fact "1") issued against the petitioner did not include the use tax due on fixed assets.

8. The petitioner offered testimony regarding drink portions served during the audit period: a six-ounce glass was used primarily for mixed drinks with ice which would contain about 3½ ounces of liquor per drink; a four and a half ounce glass was used for drinks straight up, which would contain about 3½

ounces of liquor per drink; three ounce glasses were used for shots (liqueurs, etc., with no ice) which would contain $2\frac{1}{4}$ ounces of liquor per drink; an eleven ounce glass was used for beer with about ten ounces of actual beer with the head per drink. The examiner estimated that amount of liquor served per drink to be either $1\frac{1}{4}$ ounces or $1\frac{1}{2}$ ounces, and the amount of beer served per drink to be 8 ounces.

The petitioner also offered testimony regarding the trimming of meat: the chef would generally order a 14 to 16 pound piece of beef which would then go through a double trimming; the meat would be weighed before and after trimming; the entire piece would first be trimmed of almost $5\frac{1}{2}$ to 6 pounds of fat; the chef would then slice the meat into about 8 steaks and trim each steak another 6 ounces; the resulting portion for the customer was a one pound steak. The petitioner also testified that portions served to the customer for veal chops were 24 to 26 ounces; lamb chops, 16 to 18 ounces; roast beef, 20 ounces; and chicken, 20 ounces. According to the petitioner, sixty-five to seventy percent of the customers left the restaurant with "doggie-bags."

Petitioner's testimony regarding the drink portions, meat trimming and meat portions is incredible. Petitioner offered no documentary or other substantial evidence to support his testimony.

9. As the result of a pre-hearing conference, the Audit Division agreed to reduce the use tax due on fixed assets by \$546.78 when the petitioner showed that tax was paid on the purchase of an automobile and the purchase of a heating system resulted in a capital improvement.

CONCLUSIONS OF LAW

A. 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.

B. 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 Commission, 65 A.D. 2d 44). Our review of the record reveals that in the absence of cash register tapes, which are required to be kept under section 1135 of the Tax Law, the petitioner's records were insufficient for verification of taxable sales (Licata v. Chu, ____ NY2d ____ [February 21, 1985]). Therefore, the Audit Division's use of the bar questionnaire sheet, guest checks and office experience to determine taxable sales was proper.

C. That the petition of Morton Saipe, officer of 339 Merrick Road Restaurant, Inc. is denied.

DATED: Albany, New York

APR 29 1985

STATE TAX COMMISSION

Roderick W. Chen
PRESIDENT

Francis D. Koenig
COMMISSIONER

[Signature]
COMMISSIONER