

STATE OF NEW YORK

STATE **TAX** COMMISSION

In the Matter of the Petition

of :

OAK BEACH INN CORP.

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 September 1, 1977 :
through August 31, 1981.

Petitioner, Oak Beach Inn Corp., P.O. Box 311, Babylon, New York 11702, 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 September 1, 1977 through August 31, 1981 (File No. 38146).

A hearing was held before Arthur Johnson, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 9, 1985 at 9:15 A.M. and was continued to conclusion on October 16, 1986 at 1:15 P.M., with all briefs to be submitted by March 18, 1987. Petitioner appeared by Ira S. Bezosa, **Esq.** The Audit Division appeared by John P. Dugan, **Esq.** (William **Fox, Esq.**, of counsel on October 9, 1985 and Patricia Brumbaugh, **Esq.**, of counsel on October 16, 1986).

ISSUES

I. Whether the audit procedures and tests used by the Audit Division in an examination of petitioner's available books and records were proper and whether the additional taxable sales determined as a result thereof were correct.

11. Whether it was proper for the Audit Division to extend an audit period beyond the initial period to be examined without the consent of the petitioner.

FINDINGS OF FACT

1. Petitioner, Oak Beach Inn Corp., operated a restaurant and night club. The restaurant operated for only seven months during the period at issue. It also operated a snack bar that sold such items as hot dogs, hamburgers and french fries.

2. On December 18, 1981, as the result of an audit, the Audit Division issued notices **of** determination and demands for payment of sales and use taxes due against petitioner covering the period September 1, 1977 through August 31, 1981 for taxes due of \$210,695.16, plus penalty of \$39,051.41 and interest of \$43,145.71, for a total of \$292,892.28.

3. Robert Matherson, president of petitioner corporation, executed a consent extending the period of limitation for assessment of sales and use taxes for the period September 1, 1977 through August 31, 1980 to December 20, 1981.

4. Petitioner provided the following books and records for audit: general ledger, cash receipts journal, purchases journal, purchase invoices, sales tax returns and Federal income tax returns. Petitioner also furnished cash register tapes, cash register summary sheets and cash summary sheets for April 7, 1981 to April 16, 1981. These records were not made available for any other period under audit. The auditor did not request records for periods after November 30, 1980. A cash summary sheet was prepared for each cash register. It indicated the date, cash register number, total sales, cash pay-outs, cash deposits, cash denominations and total cash count. The cash register summary sheets indicated the cash register number, total sales by category (liquor, beer, soda), receipts from the snack bar, coat check and admissions, and the number **of** free drinks. The bartenders entered a sale for

one cent on Key #4 on the cash register to account for free drinks. Petitioner recorded sales in its books and records in a lump sum amount.

5. The Audit Division attempted to reconcile the sales from the cash summary sheets with bank deposit records for April 10, 1981 to April 16, 1981.¹ The sales amounted to \$27,164.26 as compared with deposits of \$22,969.32. After adjusting for cash payouts of \$1,789.23, the difference was \$2,405.71.

6. Since petitioner's verifiable records of receipts were incomplete and inadequate, the Audit Division performed a markup test on beer, liquor and wine purchases for December 1980. The individual liquor purchases were classified as being used in mixed drinks or cocktails. In determining sizes of drinks, 1½ ounces of liquor was used for mixed drinks and 2 ounces for cocktails. Wine was considered to be served in a 4 ounce glass. An allowance of 15 percent was given for spillage and buy backs. The selling prices of drinks were furnished by petitioner. The combined markup for liquor and wine was 381.26 percent. Petitioner served only bottled beer. The markup test on beer revealed a markup of 346.7 percent. There was no allowance given for spillage or buybacks. The markup percentages were applied to the applicable purchases to arrive at sales of \$2,136,789.76. The Audit Division also determined a markup of 19.14 percent for bottled soda and estimated a 400 percent markup for soda syrup. The markup for cigarettes was 31 percent. The markup on food was estimated at 125 percent and candy at 35 percent based on office experience. The application of these percentages to purchases produced sales as follows:

Soda (bottles)	\$ 25,384.70
Soda (syrup)	47,859.50
Cigarettes	42,017.87

1 Bank deposits were not available for April 7, April 8 and April 9.

Food	735,526.59
Candy	3,354.46

The combined sales of merchandise as listed above together with beer and liquor sales of \$2,136,789.76 result in audited taxable sales of \$2,990,932.88.

7. Petitioner charged a fee for admission to the premises. The fee ranged from \$1.00 to 4.00 depending on the night of the week. Prior to December 1980, petitioner had an employee stationed at the entrance who used a hand counter to account for the number of patrons entering the premises. Inside there was another employee who collected the admission fee or a free pass from the patron. In December 1980 petitioner installed a turnstile to count the patrons. The only records petitioner made available to the Audit Division on admission receipts were the entries on the cash register summary sheet for April 7 to April 16, 1981. On audit, the Audit Division estimated admission fees for the audit period of \$1,625,478.00. An allowance of 10 percent was deducted from this amount which left taxable admission charges of \$1,462,930.20. The receipts from admissions were based on average occupancy figures provided by the Town of Babylon and estimates made from available records. No consideration was given to seasonal variations for occupancy.

8. The taxable admission charges were combined with the audited sales of merchandise to determine total taxable sales of \$4,453,863.08 for the period September 1, 1977 through November 30, 1980. Petitioner reported taxable sales of \$2,378,031.00 for the same period, leaving additional taxable sales of \$2,075,832.08 for an underreporting factor of 87.29 percent. The error factor was applied to the period December 1, 1980 through August 31, 1981 in order to update the audit through the current sales tax filing period. This resulted in increasing the additional taxable sales to \$3,006,639.46 with tax due thereon of \$210,695.16.

9. The Town of Babylon and petitioner were involved in litigation over charges by the town that petitioner violated certain fire codes, in that occupancy exceeded the legal capacity. As parr **of** the town's investigation, the town counted the number of patrons entering petitioner's premises **on** the following dates:

July 26, 1980 (Saturday)	-	1512
July 27, 1980 (Sunday)	-	1700
August 2, 1980 (Saturday)	-	1539
August 3, 1980 (Sunday)	-	1640

The Audit Division determined an average **of** 708 patrons from petitioner's records for Saturday and Sunday, March 7, March 8, April 11 and April 12, 1981. At the hearing, petitioner submitted a book of admission receipts covering the audit period. This book was not provided to the auditor during the audit because Mr. Robert Matherson felt that the contents of the book would be shared with officials from the Town **of** Babylon and be detrimental to petitioner in the pending litigation with the Town. The admissions book appears to consist of contemporaneous records maintained during the period under review. The receipts for admissions and coat check from the available cash register summary sheets agreed with the corresponding entries in the admissions book. Also the receipts shown for the days that occupancy was counted by the Town of Babylon appear to be accurate. The admissions book showed total admission receipts for the audit period of \$965,465.00, including sales tax.

10. Petitioner used many types of promotions **to** induce business. Typical specials included happy hour at which a customer received two drinks for the price of one; lifeguard night when Schmidt beer sold for 75¢; Molson night **on** Wednesday where a bottle **of** Molsons beer sold for \$1.00; Ladies night on Tuesday when ladies drank free from 8:00 P.M. until 10:00 P.M. **In** addition to the drink specials, petitioner routinely circulated passes for free admission.

The markup test performed by the Audit Division did not give any consideration for drinks sold at reduced prices.

11. On December 22, 1980 the auditor measured the size of the shot glass used by petitioner. The glass held two ounces of liquid measured to the top. Wine was served in a **six** ounce goblet.

12. The Audit Division incorrectly computed sales of Mondavi Chablis and Rose. The auditor's calculations used 12 bottles per case instead of **6** bottles. The adjustment reduced the markup percentage from 381.26 percent to 276 percent. In addition to the foregoing, petitioner argued that the markup test should be further adjusted as follows:

- a.) \$43,500 in unsold wine inventory.
- b.) Employee meals and consumption of beverages. Petitioner had a policy that an employee was entitled to one meal while working and unlimited drinks when not on duty. During the audit period, petitioner had approximately 15 employees. When the restaurant was in operation there were 25 employees.
- c.) Soda syrup sold with mixed drinks.
- d.) 15 percent allowance on beer for breakage and buybacks.
- e.) 50 percent of the Molson's beer and 25 percent of the Schmidt's beer purchased was sold during the promotion night at the reduced price.
- f.) 10 percent allowance to account for the other special drink prices.
- g.) 100 percent markup on food rather than 125 percent.

CONCLUSIONS OF LAW

A. That section 1138(a)(1) of the Tax Law provides that "if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available" and authorizes, where necessary, an estimate of tax due "on the basis of external indices".

B. That section 1135(a) of the Tax Law provides that every person required to collect tax shall keep records of every sale and of all amounts paid, charged or due thereon. Such records shall include a true copy of each sales slip, invoice, receipt or statement. Hand-recorded entries on a worksheet were not reliable records to satisfy the statutory requirements that records of individual sales be retained (Hatter of Skiadas v. State Tax Commission, 95 AD2d 971). The books and records provided by petitioner were incomplete and inadequate for purposes of verifying taxable sales. Accordingly, the Audit Division's use of a test period and markup percentage audit was a proper basis for determining petitioner's sales pursuant to the provisions of section 1138(a) of the Tax Law (Matter of Licata v. Chu, 64 NY2d 873; Hatter of Murray's Wines and Liquors, Inc. v. State Tax Commission, 78 AD2d 947).

C. That the Audit Division's markup test on liquor and wine did not use the correct drink sizes and did not give consideration to reduced selling prices of drinks for promotions. The markup on liquor and wine is adjusted to 175 percent based on a two ounce serving of liquor and 6 ounces for wine; a 10 percent reduction in sales to account for promotions, and the correction indicated in Finding of Fact "12".

D. That the markup on beer is adjusted to 215 percent by giving an allowance of 15 percent for breakage and buy backs. In addition, 50 percent of the purchases of Molson's beer and 25 percent of Schmidts Beer were considered sold at the promotional prices.

E. That the merchandise purchases determined by the Audit Division shall be adjusted as follows:

(a) beer, liquor and wine	-	\$23,400.00 (employee consumption - 20 employees @ \$1.00 per day)
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(b) soda syrup - \$ 4,785.00 (50% sold with liquor drinks)
(c) food - \$46,800.00 (employee meals, 20 employees
@ \$2.00 per day)

Petitioner is liable for use tax **on** the beverages consumed by employees.

F. That in accordance with the adjustments above, sales for the period September 1, 1977 through November 30, 1980 are redetermined below:

<u>Merchandise</u>	<u>Purchases</u>	<u>Adjustment</u>	<u>Adjusted Purchases</u>	<u>Markup</u>	<u>Sales</u>
Beer	\$241,887.76	\$11,700.00	\$230,187.76	215	\$ 725,091.44
Liquor	219,481.60	11,700.00	207,781.60	175	571,399.40
Syrup	9,571.90	4,785.00	4,786.90	400	23,934.50
Food	326,900.71	46,800.00	280,100.71	125	630,226.60
Bottle soda	21,305.19	-0-	21,305.19	19.14	25,384.70
Candy	2,484.79	-0-	2,484.79	35	3,354.46
Cigarettes	32,074.71	-0-	32,074.71	31	42,017.87
					<u>\$2,021,408.97</u>

These sales represented 85 percent of reported taxable sales for the same period. This resulted in sales of \$2,927,762.10 for the audit period.

G. That receipts from admissions and coat check were accurately recorded in the book described in Finding of Fact "9". The taxable admission and coat check receipts **of** \$902,304.00 combined with merchandise sales totaled \$3,830,066.10 as compared with reported taxable sales **of** \$3,006,639.00 for underreported sales or \$823,427.10. Accordingly, the additional sales tax found due on audit is reduced to \$57,639.89. The use tax due **on** beverages consumed by employees **is** \$1,764.00.

H. That petitioner had the burden **of** showing that the amount **of** tax assessed was erroneous (Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858). Except for the allowances set forth in Conclusion **of** Law "C", "D" and "E", petitioner failed to sustain this burden.

I. That the Audit Division **is** not limited as to the length of **an** audit period as long as such periods are not barred by the statute **of** limitations


provided in section 1147(b) of the Tax Law. Petitioner did not change the nature of the business operations during the updated periods nor did it establish that there were any additional books and records for said period that would alter the audit results. (Matter of Martin W. Stillwell, State Tax Commission, April 23, 1987.)

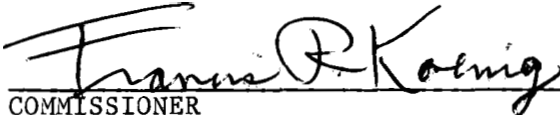
J. That the petition of Oak Beach Inn Corp. is granted to the extent indicated in Conclusion of Law "G"; the Audit Division is hereby directed to modify the notices of determination and demand for payment of sales and use taxes due issued December 18, 1981; and that, except as so granted, the petition is in all other respects denied.

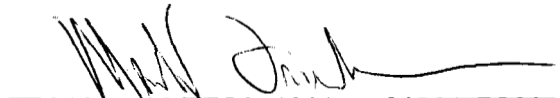
DATED: Albany, New York

STATE TAX COMMISSION

AUG 21 1987


PRESIDENT


COMMISSIONER


COMMISSIONER