STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petitions of MEGARA COFFEE SHOP, INC. AND GEORGE MANOLIS AND KONSTANTINOS KASTANIS, AS OFFICERS for Revision of Determinations or for Refunds of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period December 1, 1978 through November 30, 1982.	DECISION

Petitioners, Megara Coffee Shop, Inc. and George Manolis and Konstantinos Kastanis, as officers, 406 Flatbush Avenue Extension, Brooklyn, New York 11201, each 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 December 1, 1978 through November 30, 1982 (File Nos. 40654, 42156, 42162 and 42163).

A hearing was held before Sandra F. Heck, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on March 18, 1986 at 9:45 A.M. Petitioners appeared by Chris G. Karis, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether the audit methodology employed by the Audit Division resulted in a reasonable reflection of petitioners' sales tax liability.

II. Whether petitioners, George Manolis and Konstantinos Kastanis, are personally liable as officers of Megara Coffee Shop, Inc. for such corporation's sales tax liability.

FINDINGS OF FACT

1. On September 20, 1982, the Audit Division issued to petitioner Megara Coffee Shop, Inc. (hereinafter "Megara") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1978 through November 30, 1979 which asserted a base tax due of $25,008.40, together with a penalty of $7,002.10 and interest of $10,879.40, for a total amount due of $42,889.90. On February 20, 1983, the Audit Division issued to Megara a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1979 through November 30, 1982 which asserted a base tax due of $52,513.77, together with a penalty of $15,514.00 and interest of $10,335.03, for a total amount due of $78,362.80. For the period March 1, 1982 through November 30, 1982, the Audit Division assessed a 50 percent fraud penalty.

2. On February 20, 1983, the Audit Division issued to petitioner Konstantinos Kastanis (hereinafter "Kastanis") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1979 through November 30, 1982 which asserted a base tax due of $52,513.77, together with a penalty of $15,514.00 and interest of $10,335.03, for a total amount due of $78,362.80. As in the case of Megara, for the period March 1, 1982 through November 30, 1982, the Audit Division assessed a 50 percent fraud penalty. On February 28, 1983, the Audit Division issued to Kastanis a second Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1978 through November 30, 1979 which asserted a base tax due of $25,462.40, together with a penalty of $6,365.60 and interest of $11,300.04, for a total amount due of $43,128.04. Both such notices were issued to Kastanis as an officer of Megara pursuant to sections 1131(1) and 1133 of the Tax Law.

3. On February 20, 1983, the Audit Division issued to George Manolis (hereinafter "Manolis") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due for the period December 1, 1981 through November 30, 1982 which asserted a base tax due of $17,156.12, together with a penalty of $6,511.78 and interest of $897.51, for a total amount due of $24,565.59. The Audit Division also assessed a 50 percent fraud penalty for the period March 1, 1982 through November 30, 1982. Such notice was also issued to Manolis as an officer of Megara pursuant to sections 1131(1) and 1133 of the Tax Law.

4. By memorandum, dated October 25, 1985, the Audit Evaluation Bureau reduced the 50 percent fraud penalty assessed against all three petitioners for the period March 1, 1982 through November 30, 1982 to a 25 percent negligence penalty.

5. During the period at issue, Megara operated a coffee shop and restaurant at 406 Flatbush Avenue Extension, Brooklyn, New York. The restaurant had approximately 10 stools and 4 to 6 tables which seat 2 to 4 customers. Petitioners Kastanis and Manolis and a Dimitrious Manolis were officers of Megara.

6. A field audit was commenced in September 1981. Petitioners did not maintain cash register tapes and their books and records were fragmentary. The auditor performed an analysis of available guest checks to determine whether the proper amounts of sales tax had been charged on each transaction, also known as as an "over and under" test. On November 18, 1981, petitioners were requested to retain guest checks for the day. When the auditor returned to the premises at 12:00 noon on November 19, 1981, she was advised that the checks had been thrown away. Some checks were retrieved from the garbage and given to the auditor. As a result of the aforementioned over and under test, the auditor sent a Consent to Fixing of Tax Not Previously Determined and Assessed,

dated November 20, 1981, which stated that petitioner Megara owed $3,538.54 in sales and use tax for the period September 1, 1978 through August 31, 1981. Megara did not sign the consent and the over and under test did not form the basis of the assessments herein. Megara disagreed with the results of the over and under test and agreed to additional testing of petitioners' business operation.

7. An observation test was performed inside petitioner Megara's business premises on January 8, 1982, which test revealed that Megara's sales were significantly understated. The observation was conducted between the hours of 10:00 A.M. and 3:30 P.M., during which time sales of $615.57 were observed. The auditor next estimated sales of $369.33 ($123.11 per hour) for the period 7:00 A.M. to 10:00 A.M. Petitioners' sales per day of $984.90 were multiplied by 24 (assuming petitioners were open 6 days per week or 24 days per month) to determine gross sales per three-month sales tax period of $70,914.00. This represented a margin of error of 5.2905.

8. Following the observation test on January 8, 1982, the Audit Division sent petitioner Megara a Statement of Proposed Audit Adjustment, dated February 23, 1982, which asserted that petitioner owed $9,260.88 of tax for the period December 1, 1978 through November 30, 1981. (It should be noted that the margin of error as determined above was applied only to the periods ended August 31, 1981 and November 30, 1981.) Petitioner's representative disagreed with the extrapolation of the results of the observation test because a neighboring restaurant was closed during the observation test and it skewed the results. Through settlement negotiations, petitioner Megara's tax liability was reduced to $4,984.15. On May 5, 1982, the Audit Division sent petitioner Megara a Consent to Fixing of Tax Not Previously Determined and Assessed which asserted

that petitioner owed sales and use taxes of $4,984.15. Petitioner Megara's Vice-President signed the consent and returned it to the Audit Division. The auditor's supervisor, upon review of the information in this file, rejected the figure contained in the latest consent and a new observation test was scheduled.

9. On August 30, 1982, the auditor's supervisor observed 116 customers between the hours of 7:00 A.M. and 8:30 A.M. He felt that these numbers truly reflected the volume of business and that further observation was not necessary. However, petitioners' representative claimed that August was a "dead" month and therefore disapproved. The supervisor also observed the following purchases: 6 boxes of cakes, 2 cases of catsup, 5 boxes of eggs (30 dozen per box), 3 boxes of bacon and butter patties. (A prior review of bills by the auditor disclosed items on the menu not being reflected as purchases.) The auditor next issued the September 20, 1982 notice to Megara because petitioners' representative refused to sign a waiver extending the statute of limitations. The notice was based on the results of the January 8, 1982 observation.

10. On January 11, 1983, a new observation test was performed. Because petitioner Megara would not allow the auditor inside the premises, an observation test was performed from outside of the store between 7:45 A.M. and 3:30 P.M. The details of the audit methodology are more fully set forth as follows:

(a) It was assumed that every customer leaving the store between 7:30 A.M. and 11:00 A.M. and carrying a bag had purchased a coffee and doughnut with a value of $.80. During the observation test, 124 customers were seen leaving the premises carrying a bag.

(b) Every customer who ate inside the restaurant was assumed to have purchased a breakfast special with an average price of $1.67. (There were three breakfast specials on the menu with prices of $1.40, $1.65 and

$1.95.) During the observation test, 164 customers were observed eating in the restaurant prior to 11:00 A.M.

(c) Every customer who ate inside the restaurant after 11:00 A.M. was assumed to have spent $2.36. This figure was the average amount which appeared on the guest checks that were analyzed during the over and under test described in Finding of Fact "6" hereof. During the observation test, 188 customers were observed eating in the restaurant after 11:00 A.M. The income for the day was determined to be $834.36. This amount was averaged with the results of the first observation on January 8, 1982 performed inside the business premises to compute average quarterly sales of $60,501.27. The audited average quarterly sales were compared to reported quarterly sales to arrive at a margin of error of 4.8096 which, when applied to reported taxable sales for the audit period, resulted in additional taxes due of $77,976.17. Accordingly, the notices were issued against Megara and petitioners Kastanis and Manolis. The September 20, 1982 Notice against Megara was not adjusted.

11. An additional observation test was performed inside the store on February 1, 1984. The test was performed following the issuance of the assessments herein and following a prehearing conference. The test consisted of the auditor observing every sale rung up on the cash register. The test revealed audited daily sales of $373.49. The auditor and her supervisor did not give much credence to the results of this final observation test because, during the course of the test, petitioners refused to sell certain higher priced items off the menu, failed to ring up every sale, and blocked the auditor's view so that she could not see the register. The results of the observation tests on January 8, 1982, January 11, 1983 and February 1, 1984 were averaged together to arrive at a proposed settlement figure. The settlement was rejected by

petitioners however, and, therefore, the results of the February 1, 1984 observation test are not relevant to this proceeding.

12. Petitioners George Manolis and Konstantinos Kastanis submitted no evidence rebutting the Audit Division's assertion that they were "persons required to collect tax" on behalf of the corporation.

13. At the hearing, petitioners' representative contended that during June and July, the coffee shop is open 5 days a week; from September to May, it is open 5½ days a week; and it is closed during August. However, he presented no evidence to support his contention.

CONCLUSIONS OF LAW

A. 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 and of the tax payable thereon. Such records shall include a true copy of each sales slip, invoice, receipt or statement.

B. That section 1138(a)(1) of the Tax Law provides, in pertinent part, that if a sales and use tax return is not filed, or if 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.

C. That the books and records of Megara Coffee Shop, Inc. were inadequate and incomplete for purposes of determining taxable sales or sales tax due. Therefore, the use of external indices was permissible (Matter of Korba v. N.Y.S. Tax Commission, 84 AD2d 655). Accordingly, the Audit Division's determination of additional tax due was proper pursuant to section 1138(a)(1) of the Tax Law. Exactness is not required where it is the taxpayer's own failure to maintain proper records which prevents exactness in the determination of sales tax liability (Matter of Markowitz v. State Tax Commission, 54 AD2d 1023).

D. That petitioner George Manolis and petitioner Konstantinos Kastanis were "persons required to collect tax" pursuant to section 1131(1) of the Tax Law and as such were personally liable for the tax due from Megara Coffee Shop, Inc.

E. That the petitions of Megara Coffee Shop, Inc. and George Manolis and Konstantinos Kastanis are denied and the notices of determination and demands for payment of sales and use taxes due issued September 20, 1982, February 20, 1983 and February 28, 1983, except as modified by the Audit Division (see Finding of Fact "4"), are sustained.

DATED: Albany, New York

AUG 08 1986

STATE TAX COMMISSION

Roderick G. W. Chu
PRESIDENT

Francis R. Koenig
COMMISSIONER

COMMISSIONER