

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :

of :

JACK LaRUSSA  
D/B/A JACK'S PIZZA :

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 December 1, 1978 :  
through May 31, 1982. :

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Petitioner, Jack LaRussa d/b/a Jack's Pizza, 1576 Green Avenue, Brooklyn, New York 11237 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 May 31, 1982 (File No. 44452, 44453).

A hearing was held before Jean Corigliano, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York on November 19, 1985 at 9:15 a.m. Petitioner appeared pro se. The Audit Division appeared by John P. Dugan, Esq. (Michael J. Glannon, Esq. of counsel).

ISSUE

Whether the Audit Division correctly determined sales and use taxes due from petitioner.

FINDINGS OF FACT

1. The Audit Division issued to petitioner two notices of determination and demand for payment of sales and use taxes due. The first, dated March 18, 1982, asserted taxes due of \$1,000.00 for the period December 1, 1978 through February 29, 1979, plus penalty and interest. The second, dated February 18, 1983, asserted taxes due of \$5,600.53 for the period March 1, 1979 through May 31, 1982, plus penalty and interest.

2. On May 7, 1982, petitioner signed a consent extending the period of limitation for assessment of sales and use taxes for the taxable period March 1, 1979 through November 30, 1981 to September 20, 1982. Petitioner signed a second such consent on August 31, 1982 extending the period of limitations for the taxable period December 1, 1978 through February 29, 1980 to March 20, 1983.

3. Petitioner, Jack LaRussa, operates a small restaurant which sells pizza, hero sandwiches, soda, coffee and other snack foods. At the commencement of the audit, petitioner was asked to produce available books and records for the audit period. He referred the Audit Division's auditor to his accountant who provided copies of filed sales tax returns and federal income tax returns. These were the only records made available; because they were deemed inadequate for the purpose of verifying taxable sales, the Audit Division resorted to external indices to determine petitioner's gross sales and sales tax due thereon.

4. Petitioner's flour purchases for a twenty-two month period from May, 1980 to February, 1982 were obtained from his supplier. Using the flour purchases as a basis for his calculations, the auditor employed the following method to estimate total pizza sales for the audit period: Based on conversations with petitioner's accountant, the auditor assumed that 110 pounds of flour were used to make 95 pizzas (or approximately 1.157 pounds of flour per pizza). Allowing five percent for shrinkage, the auditor calculated that 10,174 pizzas were made in the twenty-two months for which flour purchases were available. These figures were projected over the forty-two month audit period to arrive at an estimate of 19,423 pizzas made in the audit period. It was assumed that one-third of petitioner's sales were of whole pizzas and the remainder was of

pizza slices, eight slices to a whole pizza. Using a schedule of prices charged during the audit period, the auditor calculated total taxable pizza sales of \$81,952.28.

5. Sales of food items, other than pizza, were estimated on the basis of two observation tests described below:

- a. The first test was conducted on January 8, 1982. During a one hour period (3 p.m. to 4 p.m.), two auditors observed six customers enter the restaurant. They noted that most sales consisted of a slice of pizza and a beverage, but they made no record of the number of sales that occurred, the items sold or the total amount of the sales.
- b. A second test took place on March 22, 1982 between the hours of 11 a.m. and 3 p.m. An auditor observed and kept an exact list of all sales which occurred, recording total sales other than pizza of \$8.10 during this four hour period.

Predicated on the assumption that each of the six customers observed during the first observation test "had something to eat and drink" and using posted prices, the Audit Division estimated sales other than pizza for the one hour period from 3 p.m. to 4 p.m. of \$5.20. This estimated sales figure was then added to the \$8.10 in sales actually observed during the second, four hour test to calculate sales between the hours of 11 a.m. and 4 p.m. of \$13.30. On the grounds that the results of the first observation test were more representative of late afternoon and evening sales than the results of the second test, the Audit Division utilized the \$5.20 figure to project sales of \$36.40 for the hours between 4 p.m. and 11 p.m. ( $\$5.20 \times 7$ ). This resulted in taxable sales, other than pizza, of \$49.70 per day (\$8.10 for the hours from 11 a.m. to 3 p.m.; \$41.60 for the hours from 3 p.m. to 11 p.m.) and audited taxable sales of \$58,600.46 for the audit period.

6. The auditors observed five tables and twenty chairs which appeared to be relatively new. Petitioner confirmed that this furniture was purchased

during the audit period, but he was unable to produce receipts of purchase showing that applicable sales tax was paid. Consequently, the auditors estimated the value of the tables and chairs at \$1,500.00 (\$100.00 per table and \$50.00 per chair) and assessed a use tax thereon of \$120.00. At hearing, the auditor conceded that "it was very difficult for us to really determine the actual value of it, and this was the decision between myself and my supervisor to value it at that particular amount."

7. On the basis of the audit methodology described above, the Audit Division determined additional tax due for the audit period as follows:

audited pizza sales	\$ 81,952.28
audited miscellaneous food & beverage sales	58,600.46
total audited sales	<u>\$140,552.74</u>
reported sales	<u>- 69,315.00</u>
additional taxable sales	\$ 71,237.74
additional sales tax due	5,747.73
use tax due	120.00
total tax due	<u>\$ 5,867.73</u>

A Notice of Assessment Review for the period December 1, 1978 through February 28, 1979 asserting an adjusted tax due of \$267.20 plus penalty and interest was issued to reflect these findings.

8. Petitioner does not read or write English, and his ability to speak and comprehend in English is somewhat limited. He kept no written records of sales or purchases but counted the cash on hand at the end of each day and reported the totals to his accountant by telephone or in person. He relied entirely on his accountant to prepare the sales tax returns he signed. During the course of the audit, petitioner dismissed his original accountant and retained a new one.

9. Jack's Pizza is a family-run business operated by Mr. La Russa, his wife and his children who all work in the restaurant and live in an adjacent

house. In fact, the La Russa's viewed their home and business as coextensive. As Mr. LaRussa stated, "You know, it's no business; it's my house." Many of Mr. LaRussa's relatives live in the neighborhood where the restaurant is located and frequently visited there. Approximately 10 percent of Mr. LaRussa's food purchases were made for the purpose of feeding his family either in his home or in the restaurant.

10. Although the restaurant's stated hours were 11 a.m. to 11 p.m. seven days a week, the actual hours of business fluctuated with the volume of business. The proximity of the La Russa home to the restaurant allowed Mr. La Russa to remain at home while keeping an eye on the business and to determine when to close based on the number of customers. As he said, "On the rainy day, nobody come, you know I close up at 9:00 o'clock... When you be in your house and you see nobody come to buy something, so I close it early." On an average, the business was open 10 hours per day.

11. Jack's Pizza was located in a residential neighborhood with little pedestrian traffic. Most of it's business was done at lunch time and after school. According to the auditor, the restaurant did little business during the day; "he mostly has children, you know, they all basically come in for a slice of pizza and that's about it." There was very little business done after 7:00 P.M.

12. Most of the restaurant's sales were of whole pizzas, pizza slices and beverages. Mr. La Russa used approximately 1.5 lbs. of flour for each pizza he made.

#### CONCLUSIONS OF LAW

A. That petitioner's failure to maintain records of sales, as he was required to do by section 1135 of the Tax Law, made it virtually impossible for

the Audit Division to verify the accuracy of his reported taxable sales. Under the circumstances, the Audit Division's resort to external indices to estimate the sales tax due was proper in accordance with section 1138(a) of the Tax Law, and the audit methodology chosen was reasonable under the circumstances (Matter of Grant Co. v. Joseph, 2 N.Y.2d 196).

B. That petitioner has proven that the audit findings were erroneous to the extent indicated in Findings of Fact "9", "10", "11" and "12". Consequently, the Audit Division is directed to recalculate petitioner's sales tax liability using the following criteria:

- a. Ten percent of petitioner's flour purchases were used for personal consumption. Furthermore, 1.5 pounds of flour were used to produce each pizza. Estimated gross pizza sales shall be recalculated accordingly.
- b. There is no basis for the determination that the second observation test, which was conducted over a four hour period and produced a record of actual sales made, was less reliable, less accurate or less representative of overall sales than the first test which lasted only one hour and produced no record of actual sales made. This is especially true since the first auditors specifically noted that most of the sales they observed were of a pizza slice and a beverage, while the test was used to estimate sales other than pizza. Consequently, the results of the second test (\$8.10 in a four hour period) shall be used exclusively to estimate sales other than pizza. Furthermore, this estimate shall be based on an ten hour business day.

C. That where adequate books and records are not available, the Audit Division has a duty to choose an audit method reasonably calculated to reflect the taxes due (Matter of Meyer v. State Tax Commission, 61 A.D.2d 223). The auditor's valuation of the tables and chairs had no basis whatsoever, as reflected in his statement at hearing that "this was a decision between myself and my supervisor to value it at that particular amount." Accordingly, the assessed use tax of \$120.00 is cancelled.

D. That where the taxpayer affirmatively establishes that failure to comply with the tax law was due to a reasonable cause which clearly indicates an absence of gross negligence or willful intent to evade the taxing statutes, the Tax Commission may abate interest and penalties assessable under section 1145 of the Tax Law (20 NYCRR 536.1). Petitioner attempted to compensate for his lack of fluency in English and his consequent inability to keep adequate records by engaging the services of an accountant. It was his accountant's failure to keep the required records which caused whatever underreporting of sales that may have occurred. Consequently, penalties and interest above the statutory minimum shall be abated.

E. That the petition of Jack LaRussa d/b/a Jack's Pizza is granted to the extent indicated in Conclusions of Law "B", "C" and "D"; that the notices issued on March 18, 1982 and February 18, 1983, respectively, shall be modified accordingly; that in all other respects the petition is denied.


DATED: Albany, New York

STATE TAX COMMISSION

APR 04 1986

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER