

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition

of

HEALTH FERNS, INC.

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 March 1, 1982  
through May 31, 1984.

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Petitioner, Health Ferns, Inc., c/o William Kleinberg, 920 Tee Court, Woodmere, New York 11598, 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, 1982 through May 31, 1984 (File No. 56034).

A 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 December 4, 1986 at 1:30 P.M., with all briefs to be filed by March 27, 1987. Petitioner appeared by Gerald Lotenberg, C.P.A. The Audit Division appeared by John P. Dugan, Esq. (Irwin A. Levy, Esq., of counsel).

#### ISSUE

Whether the Audit Division properly estimated the tax liability of Health Ferns, Inc. on the basis of external indices.

#### FINDINGS OF FACT

1. From March 1, 1982 to March 29, 1984, petitioner, Health Ferns, Inc., operated a coffee shop at 10 East 44th Street in New York City doing business as Thames Coffee Shop. The business was sold on March 29, 1984 to Thames Coffee Shop, Inc.

2. On July 6, 1984, the Audit Division, as the result of a field audit, issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due assessing a sales tax due of \$74,903.20, plus interest of \$7,383.35, for a total amount due of \$82,286.55 for the period March 1, 1982 through March 29, 1984. The Notice contained the following explanation:

"Since you have not submitted your records for audit as required by Section 1142 of the Tax Law, the following taxes are determined to be due in accordance with Section 1138 of the Tax Law and are based upon available records and information: This determination may be challenged through the appeals process by filing a petition within ninety (90) days."

A similar notice was issued against the purchaser, Thames Coffee Shop, Inc. No evidence was presented why penalty was not imposed against petitioner.

3. On audit, petitioner made available for review copies of its U.S. Corporation Income Tax Return for the fiscal years ended February 28, 1983 and February 29, 1984 and copies of its sales and use tax returns for the audit period. Petitioner did not utilize guest checks or cash register tapes, and no other books or records were presented to the auditor. In view of her inability to adequately determine petitioner's sales tax liability based on the information provided, the auditor requested petitioner to allow her to perform an observation test of the business premises then being operated by the purchaser. The request was denied by petitioner's accountant, identified as a Mr. Shustack. Therefore, the auditor decided to use an external index, namely the average percentage of rent expense to gross sales based on Dun & Bradstreet, Inc.'s business statistics, to determine petitioner's sales tax liability.

4. The auditor first considered all sales subject to sales tax considering the nature of petitioner's business. Next, the auditor divided rent expense as reported on petitioner's U.S. Corporation Income Tax Return for the fiscal year ended February 29, 1984 of \$43,812.00 by .05 to compute gross sales of \$876,240.00.

From this amount the auditor subtracted gross (and taxable) sales reported of \$355,600.00 to compute additional taxable sales of \$520,640.00. This amount was then divided by 4 to determine additional taxable sales per sales tax quarter of \$130,160.00. This amount was multiplied by  $8\frac{1}{4}$  percent, the combined State and City sales tax rate, to determine additional sales tax due per quarter of \$10,738.20 for the quarters ended May 31, 1983 to February 29, 1984. A similar computation was done for the period March 1, 1982 to February 28, 1983 which resulted in additional sales ~~tax~~ due per quarter of \$7,373.17 for the quarters ended May 31, 1982 to February 28, 1983. For the month of March 1984, the auditor determined additional sales tax due to be \$2,457.72 or  $\frac{1}{3}$  of the additional taxes due for the quarters ended May 31, 1982 to February 28, 1983 (\$7,373.17 divided by 3 = \$2,457.72). The above computations resulted in additional sales tax determined to be due for the audit period of \$74,903.20.

5. Petitioner argued that the business premises are located in one of the highest dollar per square foot rental locations for retail space in the City of New York and, therefore, the Dun & Bradstreet rent expense to gross sales ratio of 5 percent for the New York area is not on point with regard to this specific area.

#### CONCLUSIONS OF LAW

A. That section 1138(a)(1) of the Tax Law authorizes the use of external indices to estimate tax due. Resort to the use of external indices as a method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify such liability and conduct a complete audit (Chartair, Inc. v. State Tax Commission, 65 AD2d 44).

B. That petitioner did not use cash register tapes or guest checks. Therefore, in the absence of such documents, the Audit Division could not

verify taxable sales or ascertain the exact amount of tax due. The rent expense was properly adopted by the Audit Division to determine taxable sales and tax due.

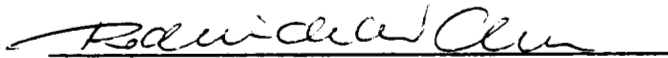
C. That it is incumbent upon petitioner to show that the additional taxes due as determined by the Audit Division were incorrect. Petitioner has not shown or substantiated errors in the methodology or result of the audit and thus no reduction of the tax found to be due is warranted (Matter of Manny Convissar v. State Tax Commission, 69 AD2d 929).

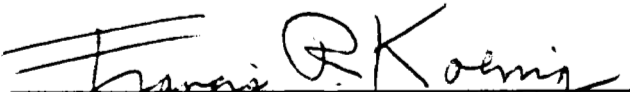
D. That the petition of Health Ferns, Inc. is denied and the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued July 6, 1984 is sustained.

DATED: Albany, New York

STATE TAX COMMISSION

JL 08 1987

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER