

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Nautilus Restaurant, Inc. :
for Redetermination of a Deficiency or Revision :
of a Determination or Refund of Corporation :
Franchise Tax under Article 9A of the Tax Law for :
the Fiscal Years Ended 5/31/79, 5/31/80 & 5/31/81. :
:

AFFIDAVIT OF MAILING

State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 7th day of November, 1985, he served the within notice of Decision by certified mail upon Nautilus Restaurant, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Nautilus Restaurant, Inc.
5523 Merrick Rd.
Massapequa, NY 11758

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
7th day of November, 1985.

David Parchuck

James J. O'Donoghue
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

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of :
Nautilus Restaurant, Inc. :
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for Redetermination of a Deficiency or Revision :
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Franchise Tax under Article 9A of the Tax Law for :
the Fiscal Years Ended 5/31/79, 5/31/80 & 5/31/81. :
:

State of New York :

ss.:

County of Albany :

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 7th day of November, 1985, he served the within notice of Decision by certified mail upon Elliot Zimmerman, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Elliot Zimmerman
1956 Lake End Rd.
Merrick, NY 11566

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
7th day of November, 1985.

David Parchuck

James A. Chasland

Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

November 7, 1985

Nautilus Restaurant, Inc.
5523 Merrick Rd.
Massapequa, NY 11758

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1090 of the Tax Law, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9, State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Elliot Zimmerman
1956 Lake End Rd.
Merrick, NY 11566
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
NAUTILUS RESTAURANT, INC.	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of Franchise Tax on Business Corporations :	:	
under Article 9-A of the Tax Law for the Fiscal	:	
Years Ended May 31, 1979, May 31, 1980 and	:	
May 31, 1981.	:	

Petitioner, Nautilus Restaurant, Inc., 5523 Merrick Road, Massapequa, New York 11758, filed a petition for redetermination of a deficiency or for refund of franchise tax on business corporations under Article 9-A of the Tax Law for the fiscal years ended May 31, 1979, May 31, 1980 and May 31, 1981 (File No. 42955).

A hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on July 10, 1985 at 9:15 A.M. Petitioner appeared by Elliot Zimmerman, CPA. The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUE

Whether the Audit Division properly relied upon a sales tax assessment against petitioner in calculating franchise tax deficiencies for corresponding periods.

FINDINGS OF FACT

1. On December 27, 1982, the Audit Division issued to petitioner, Nautilus Restaurant, Inc., three notices of deficiency, asserting additional franchise tax due under Article 9-A of the Tax Law for the fiscal years ended May 31,

1979, May 31, 1980 and May 31, 1981 in the respective amounts of \$3,434.10, \$3,603.90 and \$2,568.00, plus interest and negligence penalties pursuant to section 1085(d).

2. Petitioner operates a diner in Massapequa, New York.

3. The franchise tax deficiencies under consideration in this proceeding ensued from a sales tax examination, during the course of which petitioner's sales and use tax returns for the period June 1, 1978 through February 28, 1981 were reviewed.

The sales tax examiner compared petitioner's gross sales as reflected in its federal corporation income tax returns, sales and use tax returns and books of original entry and found the amounts were in substantial agreement. He also reconciled petitioner's purchases per its books and per its federal returns.

Petitioner furnished its customers with guest checks and rang sales on cash registers which produced tapes. The guest checks and register tapes were discarded, however, after a principal of the corporation accounted for all guest checks issued to waiters and waitresses, reconciled the checks to sales rung on the register and recorded sales in the day book. Subsequent to the commencement of the sales tax audit, petitioner retained guest checks and tapes for the then current period. The examiner deemed these guest checks insufficient for audit because gaps were present in the numerical sequence. Petitioner explained that the "gaps" were attributable to the issuance of different numerical series to different shifts of employees (e.g., the issuance of guest checks 2,000 et seq. to the day shift and 5,000 et seq. to the evening shift).

The examiner calculated petitioner's overall markup as 122 percent, by reference to the federal returns. He deemed this percentage low for the

industry and communicated his opinion to petitioner's independent accountant. The examiner and petitioner's accountant thereafter engaged in negotiations which culminated in their agreement that food purchases would be marked up by 142 percent. The examiner did not perform markup testing of food: he did not review costs and selling prices to determine the actual markup of selected items. The examiner's arithmetical steps in arriving at audited food sales are summarized below.

Audited food sales	
food purchases	\$ 684,959
less: increase in inventory	(3,100)
less: decrease in accounts payable	(12,159)
less: expenses erroneously classified as food purchases	(7,400)
less: employee meals	(20,323)
adjusted food purchases	<u>\$ 641,977</u>
markup 142%	911,607
audited food sales	<u>\$1,553,584</u>

Markup tests were conducted on petitioner's liquor and beer purchases during June, 1981. Utilizing costs as reflected in purchase invoices and selling prices as furnished by petitioner, the examiner computed markup percentages for liquor and for beer of 344.44 percent and 230.31 percent, respectively. By analysis of petitioner's liquor and beer purchases for the period September 1, 1980 through February 28, 1981, he determined that liquor represented 67.12 percent of such purchases and beer, 32.88 percent. These percentages, when applied to petitioner's purchases throughout the audit period, yielded liquor purchases in the amount of \$22,056.00 and beer purchases of \$10,805.00. Finally, he marked up petitioner's purchases of liquor and beer by the appropriate percentage.

Audited liquor and beer sales	
liquor purchases	\$ 22,056
markup 344%	<u>75,873</u>
audited liquor sales	<u>\$ 97,929</u>

beer purchases	\$ 10,805
markup 230%	24,852
audited beer sales	<u>\$ 35,657</u>
audited liquor and beer sales	\$133,586

In sum, audited taxable sales totalled \$1,687,170.00, which when reduced by reported taxable sales of \$1,591,110.00, resulted in additional sales of \$96,060.00 upon which sales tax of \$6,724.20 was assessed. The examiner apportioned the additional taxable sales to the quarterly periods at issue by the application of an error rate of 6.03729 percent (additional taxable sales \$96,060.00/reported taxable sales \$1,591,110.00).

The examiner also reviewed petitioner's fixed asset acquisitions during the audit period and found purchases of \$1,160.00 subject to use tax of \$81.20.

Weighing the amount of the proposed assessment against the expense of pursuing a protest, petitioner consented to the assessment. In his report, the examiner made an annotation to signify that petitioner's gross sales had been increased by a figure in excess of \$10,000.00 per year; it was his understanding that the annotation would initiate a review of the report for the purpose of determining whether an income tax or franchise tax examination was warranted. Petitioner was not advised of the possibility that the sales tax assessment might form the basis for an income tax or franchise tax deficiency.

4. The franchise tax deficiencies were predicated solely on the sales tax examination: the income tax examiner considered the additional taxable sales as increments to petitioner's entire net income for corresponding periods. The examiner reviewed petitioner's general ledger, cash receipts and disbursements journal and record of adjusting entries for the fiscal year ended May 31, 1981 for the purpose of verifying petitioner's expenses as deducted, but did not

employ any indirect method of income reconstruction to corroborate the sales tax examination results. Finding that petitioner's expenses were properly recorded and deducted for fiscal year 1981, the examiner decided not to conduct any review of fiscal years 1979 and 1980.

CONCLUSIONS OF LAW

A. That in view of the inadequacy of petitioner's record keeping, particularly its failure to retain cash register tapes and guest checks, the Audit Division's resort to markup testing procedures to verify petitioner's reported taxable sales was warranted. Purchase markup analyses also constitute an appropriate means of reconstructing a taxpayer's taxable income, and the results thereof may properly be employed as a basis to assert an income tax deficiency (Matter of William T. Kelly, State Tax Comm., December 31, 1984; Matter of Carmen and Adelia Garzia, State Tax Comm., June 29, 1983). Thus, additional taxable sales as disclosed by the liquor and beer markup tests may be considered additional entire net income for franchise tax purposes.

The markup percentage applied to petitioner's food purchases, however, was the product of negotiations between the sales tax examiner and petitioner's accountant and was not computed by actually determining the difference between costs and selling prices. The use of this negotiated figure for additional, taxable food sales does not vitiate the sales tax assessment to which petitioner, after all, consented, but petitioner was not made aware of and clearly did not accede to its use for franchise tax purposes. Consequently, such figure without more cannot support the franchise tax deficiencies asserted.


B. That the petition of Nautilus Restaurant, Inc. is granted to the extent indicated in Conclusion of Law "A"; the Audit Division is directed to

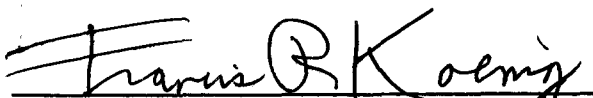
cancel the portion of the deficiencies based on additional, taxable food sales;
and, except as so modified, the deficiencies are in all other respects sustained.

DATED: Albany, New York

STATE TAX COMMISSION

NOV 07 1985


PRESIDENT


COMMISSIONER


COMMISSIONER