

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
William T. Kelly :
AFFIDAVIT OF MAILING
for Redetermination of a Deficiency or for Refund :
of New York State Personal Income Tax and :
Unincorporated Business Tax under Articles 22 and :
23 of the Tax Law and New York City Personal Income :
Tax under Chapter 46, Title T of the Administrative :
Code of the City of New York for the Years 1978 and :
1979. :

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 31st day of December, 1984, he served the within notice of Decision by certified mail upon William T. Kelly, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

William T. Kelly
9302 Ridge Blvd.
Brooklyn, NY 11209

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
31st day of December, 1984.

David Parchuck

Nicola J. Williams
Authorized to administer oaths
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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of :
William T. Kelly :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or for Refund :
of New York State Personal Income Tax and :
Unincorporated Business Tax under Articles 22 and :
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Tax under Chapter 46, Title T of the Administrative :
Code of the City of New York for the Years 1978 and :
1979. :

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 31st day of December, 1984, he served the within notice of Decision by certified mail upon Theodore Harris, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Theodore Harris
51 Madison Ave.
New York, NY 10010

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
31st day of December, 1984.

David Parchuck

Nicola J. Williams
Authorized to administer oaths
pursuant to Tax Law section 174

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

December 31, 1984

William T. Kelly
9302 Ridge Blvd.
Brooklyn, NY 11209

Dear Mr. Kelly:

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) 690, 722 & 1312 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, 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
Theodore Harris
51 Madison Ave.
New York, NY 10010
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition	:	
	:	
of	:	
	:	
WILLIAM T. KELLY	:	DECISION
	:	
for Redetermination of a Deficiency or for	:	
Refund of New York State Personal Income Tax	:	
and Unincorporated Business Tax under Articles	:	
22 and 23 of the Tax Law and New York City	:	
Personal Income Tax under Chapter 46, Title T	:	
of the Administrative Code of the City of New	:	
York for the Years 1978 and 1979.	:	

Petitioner, William T. Kelly, 9302 Ridge Boulevard, Brooklyn, New York 11209, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax and unincorporated business tax under Articles 22 and 23 of the Tax Law and New York City personal income tax under Chapter 46, Title T of the Administrative Code of the City of New York for the years 1978 and 1979 (File No. 36025).

A formal 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 June 8, 1984 at 9:15 A.M., with all briefs to be submitted by September 4, 1984. Petitioner appeared by Theodore Harris, Esq. The Audit Division appeared by John P. Dugan, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

ISSUES

I. Whether for New York State and New York City personal income tax purposes and for unincorporated business tax purposes, petitioner realized additional, unreported income in 1978 and 1979 as disclosed by a sales tax examination conducted of Kelly's Tavern.

II. Whether for New York State and New York City personal income tax purposes, petitioner realized additional, unreported income in 1979 in the form of gambling winnings.

FINDINGS OF FACT

1. On October 7, 1981, the Audit Division issued to petitioner, William J. (sic) Kelly, a Notice of Deficiency, asserting additional New York State personal income tax, unincorporated business tax and New York City personal income tax under Article 22 of the Tax Law, Article 23 of the Tax Law and Chapter 46, Title T of the Administrative Code of the City of New York, respectively, for the years 1978 and 1979 in the combined amount of \$7,221.00, plus interest. A Statement of Personal Income Tax Audit Changes and a Statement of Unincorporated Business Tax Audit Changes, previously issued to petitioner on May 27, 1981, advised petitioner that "additional income" as found upon a sales tax audit was deemed subject to New York State and City personal income tax and unincorporated business tax. The computation of the taxes due is summarized below.

(a) Personal income tax	<u>1978</u>	<u>1979</u>
Additional income per sales tax audit	\$18,200	\$15,813*
Taxable income previously stated	<u>32,063</u>	<u>28,740</u>
Corrected taxable income	\$50,263	\$44,553
 N.Y.S. tax on corrected taxable income	 \$ 5,207	 \$ 4,485
N.Y.C. tax on corrected taxable income	<u>1,761</u>	<u>1,516</u>
Corrected tax	\$ 6,968	\$ 6,001
Tax previously reported	<u>(3,961)</u>	<u>(3,409)</u>
Additional tax due	\$ 3,007	\$ 2,592

* For the period 1/1-8/31/79

(b) Unincorporated business tax

	<u>1978</u>	<u>1979</u>
Additional income per sales tax audit	\$18,200	\$15,813*
Taxable business income previously stated	<u>18,875</u>	<u>15,912</u>
Corrected taxable income	\$37,075	\$31,725
Unincorporated business tax on corrected taxable income	\$ 1,854	\$ 1,428
Unincorporated business tax previously reported	<u>(944)</u>	<u>(716)</u>
Additional tax due	\$ 910	\$ 712

* For the period 1/1-8/31/79

2. Subsequent to the issuance of the Notice of Deficiency, petitioner filed an amended 1979 U.S. Individual Income Tax Return whereon he reported:

(a) additional income consisting of gambling winnings in the amount of \$4,632; (b) an increase in the amount of \$43 to the sales tax deduction previously claimed; and (c) an increase of \$3,100 to the gambling losses deduction previously claimed. As a result of these changes, and by way of such amended return, petitioner sought a refund from the Internal Revenue Service of \$345.

In an amendment to its answer to the petition, the Audit Division asserted a deficiency against petitioner in New York State and City personal income tax for 1979, in addition to that asserted in the Notice issued on October 7, 1981, in the amount of \$1,036. The additional deficiency resulted from an error in petitioner's computation of the maximum tax on personal service income and from the previously unreported gambling winnings.

3. For the past 21 years, petitioner has owned and operated Kelly's Tavern, a neighborhood bar and grill, as a sole proprietorship. The tavern is open for business 20 hours per day Monday through Saturday, and 16 hours on Sundays. Mr. Kelly is present on the premises approximately 15 hours daily; when he is not present, the bartender or bartenders on duty are responsible for collecting cash from patrons and ringing sales on the cash registers. Petitioner

offers to patrons free-of-charge a buffet of sandwiches and cold cuts each day between 2 P.M. and 6 P.M. The tavern does not give guest checks to its patrons.

4. From September, 1979 through April, 1980, the Audit Division conducted an examination of the books and records of Kelly's Tavern for the purpose of verifying taxable sales reported for the period September 1, 1976 through August 31, 1979. On November 1, 1979, Mr. Kelly executed a consent extending the period of limitations for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law for the entire period under review to December 20, 1980.

Because Mr. Kelly was not present at the tavern during all its business hours and his employees thus operated the cash registers, the examiner decided to perform a markup test to measure taxable sales. The examiner developed a markup percentage for beer of 216.05 and for liquor and wine of 292.04: he analyzed petitioner's purchases for the test period June 1 through August 31, 1979, allowed a 15 percent margin for spillage, breakage and buybacks, and used selling prices provided by petitioner. (The examiner contrasted the computed markups with the aggregate gross profit of 151 percent reflected on petitioner's federal income tax returns for the years 1977 and 1978.) He treated one-half of petitioner's food purchases as furnished to patrons without charge and applied a markup of 125 percent, based on office experience, to the remaining food purchases.

By application of these markups to the respective categories of purchases for the audit period, the examiner computed taxable sales, which when compared to taxable sales reported, yielded an error rate of 16.47 percent.

Additional, unreported taxable sales of \$54,791.56 were assessed, resulting in sales tax liability of \$4,383.32, plus interest.¹

5. Mr. Kelly conferred with Michael Stein, a certified public accountant who had been rendering accounting services for him and for the tavern for approximately twenty years, with regard to the sales tax examination results. Messrs. Kelly and Stein were of the opinion that taxable sales had been properly reported for the period September 1, 1976 through August 31, 1979 and that the proposed assessment was incorrect. Weighing the amount of the liability against the costs of protesting the adjustments, however, it was decided that the assessment should be paid. On November 15, 1979, petitioner executed a Consent to Fixing of Tax Not Previously Determined and Assessed, agreeing that sales tax in the sum of \$4,383.32 was due from Kelly's Tavern for the period September 1, 1976 through August 31, 1979, and on or about the same date, paid such amount with interest.

6. After completion of the sales tax audit, an income tax examiner computed the New York State and City personal income tax deficiencies at issue in this proceeding by treating additional taxable sales revealed by the sales tax audit of \$18,200 for 1978 and \$15,813 for 1979 (January 1 through August 31) as additional taxable income realized by petitioner in such years; he also treated the additional taxable sales amounts of \$18,200 and \$15,813 as additional taxable business income in 1978 and 1979, respectively, subject to unincorporated business tax. The deficiencies were thus computed solely with reference to the sales tax examination results, and not by a net worth analysis or an analysis of bank deposits.

¹ Fixed asset purchases and recurring expenses were also examined but no use tax was found due thereon.

7. Petitioner was not informed at any point in the course of the sales tax examination that the results would or might be employed to determine personal income tax and unincorporated business tax deficiencies. He accordingly maintains that his decision not to contest the sales tax adjustments would have been different had he been aware of the potential personal income tax and unincorporated business tax liability (and potential federal income tax liability) which would arise therefrom.

8. Petitioner alleges that because the tavern employees were not constantly supervised, employee pilferage of cash receipts was possible and that this possibility was not considered in calculating the sales tax adjustments and income tax deficiencies. Petitioner introduced no evidence to support his claim, and his accountant testified that he had not conducted any investigation to reveal pilferage of cash.

9. Petitioner's amended 1979 federal return was apparently submitted at the request of the Internal Revenue Service. His reported gambling winnings consisted of two trifectas won at the Hialeah racetrack during a vacation in Florida; his losses arose from wagers placed at Hialeah and at the Meadowlands racetrack in New Jersey. In cumulating the gambling losses used to offset the gambling winnings, petitioner and Mr. Stein reviewed petitioner's losing tickets.

By notice dated March 29, 1982, the Internal Revenue Service informed petitioner that it accepted his amended return as filed and that his requested refund of \$345 was allowed.

The Audit Division concedes the correctness of petitioner's increased sales tax deduction, but opposes his deduction of gambling losses as unsubstantiated.

CONCLUSIONS OF LAW

A. That the employment by the Audit Division of a purchase markup analysis to determine additional sales tax due from petitioner was warranted and proper in view of the inadequacy of petitioner's record keeping. While such methodology is commonly used to calculate additional, unreported taxable sales for purposes of Articles 28 and 29, it is also an appropriate means of reconstructing a taxpayer's taxable income, and for purposes of Articles 22 and 23 there is no obligation on the part of the Audit Division to first attempt a net worth or bank deposits analysis. (See DiLando v. Commr., 34 T.C.M. [CCH] 1046; Matter of Carmen and Adelia Garzia, State Tax Comm., June 29, 1983.) Petitioner's argument that he would not have agreed to and paid the sales tax liability had he been made aware of the potential income tax consequences thereof is untenable. The hearing held herein afforded him a full opportunity to refute the markup analysis, yet he failed to submit any evidence which would tend to show the audit results were in error.

B. That petitioner realized additional, unreported income of \$4,632 in 1979 in the form of gambling winnings but failed to substantiate claimed gambling losses of \$3,100.

C. That the petition of William T. Kelly is denied, and the Notice of Deficiency issued on October 7, 1981, as increased by the amended answer of the Audit Division (Finding of Fact "2") and subsequently reduced by a concession of the Audit Division (Finding of Fact "9"), is sustained.

DATED: Albany, New York

STATE TAX COMMISSION

DEC 31 1984

Rodwinich wclm
PRESIDENT
Francis R K Oung
COMMISSIONER
Mark J. Ouellet
COMMISSIONER