

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :
of :
MAJESTIC DELI GROCERY, INC. : DECISION
for Revision of Determinations or for Refund of Sales : DTA NOS. 825624
and Use Taxes under Articles 28 and 29 of the Tax Law : AND 825625
for the Period March 1, 2009 through November 30, 2011. :
:

In the Matter of the Petition :
of :
AHMED ALAMRANI :
for Revision of Determinations or for Refund of Sales :
and Use Taxes under Articles 28 and 29 of the Tax Law :
for the Period March 1, 2009 through November 30, 2011. :
:

Petitioners Majestic Deli Grocery, Inc., and Ahmed Alamrani filed an exception to the determination of the Administrative Law Judge issued on March 3, 2016. Petitioners appeared by the Antonious Law Firm (Jacqueline S. Kafedjian, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Robert A. Maslyn, Esq. of counsel).

Petitioners filed a brief in support of their exception. The Division of Taxation filed a brief in opposition. Petitioners filed a reply brief. Oral argument was heard on October 20, 2016, in New York, New York, which date began the six-month period for the issuance of this decision.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether the Division of Taxation properly determined additional sales taxes due from petitioners, Majestic Deli Grocery, Inc., and Ahmed Alamrani, for the period March 1, 2009 through November 30, 2011, or whether petitioners have shown error in the audit method or results.

II. Whether penalties imposed under Tax Law § 1145 (a) (1) (i) and (vi) should be abated.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge, except that we have modified finding of fact 38 and we have added new findings of fact numbered 42 and 43. We make these changes to more fully reflect the record. The Administrative Law Judge's findings of fact, the modified finding of fact, and the new findings of fact are set forth below.

1. During the period in issue, petitioner Majestic Deli Grocery, Inc. (Majestic Deli Grocery) owned a deli and grocery store located at 3520 Broadway, at 144th Street, in Harlem. The business had four employees, was open 24 hours a day, seven days per week, and provided 24-hour delivery service with a minimum purchase.

2. Majestic Deli Grocery was incorporated on December 13, 2007. Petitioner Ahmed Alamrani at all relevant times was the president and a shareholder of Majestic Deli Grocery. Mr. Alamrani, as president, signed Majestic Deli Grocery's application for registration as a sales tax vendor (form DTF-17). He was also responsible for signing and filing the corporation's sales tax returns.

3. Majestic Deli Grocery reported \$314,110.00 in gross sales for 2009, \$466,583.00 in gross sales for 2010, and \$478,260.00 in gross sales for 2011 on its federal income tax returns.

4. During the audit period at issue, consisting of 11 sales tax quarters (a period of two

years and nine months), Majestic Deli Grocery reported on its sales tax returns total gross sales of \$1,202,746.00 and total taxable sales of \$223,957.00. It also claimed total prepaid cigarette tax credits of \$4,295.00, and total vendor collection credits of \$989.00 for the period March 1, 2009 through November 30, 2011.

5. By letter dated December 21, 2011, the Division of Taxation (Division) advised Majestic Deli Grocery that a sales tax field audit of its books and records for the period March 1, 2009 through November 30, 2011 would commence on January 13, 2012. This audit appointment letter advised Majestic Deli Grocery that all of its books and records pertaining to its sales and use tax liability for the audit period should be available for review on the audit appointment date. An attached information document request specified a detailed listing of particular records that were to be available for the entire audit period, including sales tax returns; worksheets and canceled checks; federal income tax returns; New York State corporation tax returns; general ledger; general journal and closing entries; sales invoices; all exemption documents supporting nontaxable sales; chart of accounts; fixed asset purchase and sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements and deposit slips; cash receipts journal; cash disbursements journal; the corporate book, including minutes, board of directors, and articles of incorporation; depreciation schedules; State Liquor Authority license; lease contracts; utility bills; guest checks; and cash register tapes.

6. On December 21, 2011, the auditor sent third-party letters to some suppliers. According to the tax field audit record (audit log), the auditor received a total of eight third-party responses on various dates between December 23, 2011 and January 30, 2012.

7. On January 10, 2012, the auditor received a faxed power of attorney appointing Jacqueline S. Antonious, Esq., as Majestic Deli Grocery's representative. Mr. Alamrani, as

president of Majestic Deli Grocery, executed this power of attorney.

8. On January 25, 2012, the auditor made a 15-minute field survey of Majestic Deli Grocery, a deli and grocery store located in a mixed residential and commercial area.¹ She noted that lottery tickets were sold, ATM services were available in the store, credit cards (Visa and Master Card) and food stamps were accepted, take-out was advertised, and take-out menus were available that indicated the store was open 24 hours a day. The auditor observed that there was one cash register (sales were not rung up), food was sold in a heated state, cigarettes were sold (cigarette prices per pack of \$10.25 and \$11.50 were noted), and the store had a 14-door refrigerator for the taxable beverages and one open refrigerator for juice and milk. The auditor further observed that the premises was busy, with “about 10 customers within 15 min. 4 - 5 of them from prepared food.” Taxable items sold included phone cards, candy, household products, gum, hot beverages, prepared food, soda and beer. Nontaxable items sold included ice cream, cake, “news,” juice, crackers, chips, milk, nuts, and cold cuts by the pound. During the field survey, the auditor also obtained a menu from the business.

9. At the request of Ms. Antonious, the field audit appointment was rescheduled for March 19, 2012. On February 9, 2012, the auditor left a message for Ms. Antonious and requested that all purchase invoices be available for review at the March 19, 2012 appointment.

10. On March 19, 2012, the auditor, Miranda Chung, met with Ms. Antonious who produced the corporation’s federal income tax returns for the years 2009 and 2010; New York State corporation tax returns for the years 2009 and 2010; some merchandise purchase invoices for the years 2010 and 2011; the corporation’s monthly checking account statements for the

¹ Riverbank State Park, which has athletic fields and picnic areas, is located across Riverside Drive from the business.

periods January 1, 2009 through September 30, 2011, and November 1, 2011 through November 30, 2011; and sales tax returns for the period March 1, 2009 through November 30, 2011.

Neither sales source documents, such as cash register tapes or a day book, nor the general ledger, cash receipts journal and cash disbursements journal for the audit period at issue were provided to the auditor during the March 19, 2012 appointment. The audit log entry for March 19, 2012 noted, among other things, that the corporation did not maintain any sales records, such as cash register tapes or a day book, for the audit period. During the appointment, the auditor asked Ms. Antonious how the sales tax returns were prepared, and Ms. Antonious stated bank deposits plus purchase information. Ms. Antonious also stated that Majestic Deli Grocery had a promotion for a free soda with the purchase of a sandwich. The auditor was advised by Ms. Antonious that the responsible person and sales tax examination questionnaires would be provided on the following day, i.e., March 20, 2012.

11. During the March 19, 2012 field audit appointment, the auditor reviewed the bank deposits and performed a gross sales reconciliation between the bank deposits and the sales tax returns for the audit period at issue, and found that the gross sales reported on the sales tax returns were higher. She also performed a gross sales reconciliation between the federal income tax returns and the sales tax returns, and found that the gross sales reported on the sales tax returns were higher. In addition, the auditor reviewed the available merchandise purchase invoices, and found them to be incomplete and in no particular order. She transcribed purchase information from Beehive Beer Distributing (Beehive Beer) invoices bearing dates between May 19, 2010 and November 23, 2011, and Losito Provisions invoices bearing dates between May 17, 2010 and November 28, 2011. With respect to the cigarette purchase invoices, the auditor was unable to perform a test of the prepaid cigarette tax because the cigarette purchase invoices provided were incomplete.

12. Subsequently, the auditor made a number of oral (telephone) requests to Ms. Antonious regarding the provision of the responsible person and sales tax questionnaires to the auditor. During an April 20, 2012 telephone call, the auditor made an oral request for the corporation's books and records for the audit period at issue, and Ms. Antonious responded that she had provided everything available at the first audit appointment. During this same telephone call, the auditor explained that Majestic Deli Grocery had not provided cigarette purchase invoices in auditable condition at the first audit appointment.

13. The auditor reviewed the records provided to her to date and determined that they were inadequate for a detailed audit. On April 26, 2012, the auditor prepared preliminary computations of additional tax due for the period March 1, 2009 through November 30, 2011 based upon available information on file (the corporation's taxable third-party purchases). To compute taxable sales of beer, soda, other beverages, and phone cards, the auditor used purchase information from third-party suppliers, and applied a markup of 141.42% (average markup per federal income tax returns for the years 2009 and 2010). To determine taxable sales of cold cuts and prepared sandwiches, the auditor applied a markup of 141.42% to Losito Provisions invoices for the period May 17, 2010 through November 28, 2011 (seven quarters) plus projected cold cut purchases for March 1, 2009 through April 30, 2010 (four quarters). The auditor estimated prepared food (coffee) at \$45.00 per day, then multiplied that amount by seven days per week, 13 weeks per quarter, for 11 quarters. To determine taxable cigarette sales, the auditor applied a markup of 118.72% (markup using the Division's Publication 509 selling prices) to Amsterdam Tobacco's third-party information for the quarters ending May 31, 2009, August 31, 2009, November 30, 2009, November 30, 2010 and February 28, 2011, plus projected cigarette purchases for the quarters ending February 28, 2010, May 31, 2010, August 31, 2010, May 31, 2011, August 31, 2011 and November 30, 2011. Based upon her computations, the auditor

determined total audited taxable sales to be \$1,736,854.00 and quarterly taxable sales to be \$157,896.00. The auditor subtracted reported taxable sales of \$223,957.00 from audited taxable sales of \$1,736,856.00, and computed additional taxable sales to be \$1,512,899.00, with tax due on such additional taxable sales to be \$133,047.51, then disallowed vendor collection credits in the amount of \$989.00, and determined total additional tax due in the amount of \$134,036.51. A schedule of additional tax due per purchases was prepared that detailed the auditor's preliminary computations. This schedule was mailed to Ms. Antonious for review and further discussions to resolve the pending issues.

14. During an April 27, 2012 conference call with her team leader and Ms. Antonious, the auditor explained that due to Majestic Deli Grocery's inadequate books and records for the audit period, additional tax due was calculated based upon available information on file (taxable third-party purchases), i.e., the schedule of additional tax due per purchases detailed above. Ms. Antonious stated again that Majestic Deli Grocery did not maintain any sales records, such as cash register tapes or a day book, for the entire audit period. During this conference call, the auditor requested that corporation and responsible person waivers be executed to extend the statute of limitations for the period March 1, 2009 through November 30, 2009, in order to give the Division time to finish the case. Ms. Antonious stated that she would speak with the vendor.

15. On April 27, 2012, Ms. Antonious executed a consent on behalf of the corporation extending the time for determination of sales and use taxes for the period March 1, 2009 through November 30, 2009 until December 20, 2012. Such executed consent was received by the auditor on April 30, 2012.

16. During the course of the audit, Ms. Antonious verbally stated that Mr. Alamrani was the responsible person for the corporation. On April 30, 2012, the auditor received an individual power of attorney, executed by Mr. Alamrani, appointing Ms. Antonious as his representative.

On May 1, 2012, the auditor spoke with Ms. Antonious via the telephone and requested the responsible person waiver, the sales tax examination questionnaire and the responsible person questionnaire be returned to her. Ms. Antonious stated that Mr. Alamrani had all the forms and she would get them the next day. Despite numerous requests for the submission of an executed responsible person waiver, Mr. Alamrani refused to execute the responsible person waiver (consent) to extend the time for assessing tax for the period March 1, 2009 through August 31, 2009.

17. No other books and records were provided to the auditor. The auditor reviewed the records provided to her and determined that they were inadequate for a detailed audit. Source documents such as cash register tapes, day book and cash payout schedules were not maintained for the audit period. The absence of source sales documents made it impossible for the auditor to trace any transaction back to the original source or forward to a final total. Therefore, the auditor determined that an observation of the business was necessary. By letter dated May 11, 2012, the auditor informed Ms. Antonious that an observation of Majestic Deli Grocery's place of business would take place in the next six weeks because the corporation failed to provide appropriate books and records necessary for the auditor to conduct a detailed sales and use tax audit. By letter dated June 4, 2012, Ms. Antonious advised that the corporation refused to allow an observation.

18. In lieu of an observation, the auditor obtained third-party information from some of Majestic Deli Grocery's suppliers. In addition, the auditor obtained third-party information from the Division's own databases that are maintained to assist in audits.

19. Due to an expiring statute of limitations, and Mr. Alamrani's refusal to sign a consent to extend the period of limitations, two separate audit computations were performed.

20. For the period March 1, 2009 through August 31, 2009, the auditor reviewed

purchases of beer, soda, other beverages, and phone cards, all of which are taxable. Using the third-party purchase information available to her for those items, and since Majestic Deli Grocery provided no information to determine an exact markup percentage for each item, the auditor determined an overall markup of 41.42%, derived from a two-year average of the markup shown on the corporation's 2009 and 2010 federal income tax returns.² She applied that markup percentage to the total purchases of those items for the two quarters.

In addition, for cigarette purchases, the auditor used Majestic Deli Grocery's cigarette purchases listed in the Division's database for five months, March 2009 through July 2009, to which she applied the 22% markup percentage listed in the Division's Publication 509, Minimum Wholesale and Retail Cigarette Prices.³ The auditor used the markup percentage listed in Publication 509 instead of the prices she observed during her survey of the business on January 25, 2012, because she felt it would be unfair to use a later, higher price for an earlier period. From the cigarette invoices provided by the corporation, the auditor was unable to determine the number of packs purchased or the total amount of the prepaid cigarette tax. There was no sales information to substantiate the incomplete information provided to the auditor. Moreover, no evidence of prepaid tax on cigarettes was provided to substantiate the credit taken on the returns. Nevertheless, the auditor allowed the amounts of prepaid cigarette tax claimed by Majestic Deli Grocery on its returns for the quarters ended May 31, 2009 and August 31, 2009, i.e., \$196.00 and \$193.00, respectively.

21. The auditor computed additional tax due for the first period, March 1, 2009 through

² To determine the 41.42% markup, the auditor first divided gross profit by cost of goods sold reported on the corporation's federal income tax returns for the years 2009 and 2010 to determine the markup for each such year, i.e., 42.15% (93,141/220,969) for the year 2009 and 40.69% (134,947/331,636) for the year 2010. She then added 42.15% and 40.69%, divided the sum of 82.84% by 2, and determined the average markup to be 41.42%.

³ The auditor used the highest price per pack listed in Publication 509 (4/09) for sales within New York City of \$9.61 for three months, and the highest price per pack listed in Publication 509 (8/09) for sales within New York City of \$9.63 for two months.

August 31, 2009 as follows: third-party purchases for beer (\$86,179.41), soda and other beverages (\$26,709.60), and phone cards (\$6,981.90) amounted to a total of \$119,870.91, to which the 41.42% markup was applied, and total sales of those items were determined to be \$169,522.00 for that period. Additionally, cigarette purchases for the five months totaled \$86,091.45 for 10,810 packs of cigarettes, to which the 22% markup was applied, resulting in cigarette sales of \$105,032.00 for the period March 1, 2009 through August 31, 2009. The auditor added total taxable sales of beer, soda and other beverages, and phone cards in the amount of \$169,522.00 and total cigarette sales of \$105,032.00, and determined audited taxable sales to be \$274,554.00 and quarterly audited taxable sales to be \$137,277.00. For the quarter ending May 31, 2009, the auditor subtracted reported taxable sales of \$11,032.00 from quarterly audited taxable sales of \$137,277.00, computed additional taxable sales in the amount of \$126,245.00, applied the tax rate of 8.375%, and determined tax due of \$10,573.02. For the quarter ending August 31, 2009, the auditor subtracted reported taxable sales of \$11,362.00 from quarterly audited taxable sales of \$137,277.00, computed additional taxable sales in the amount of \$125,915.00, applied a tax ratio of 8.542%,⁴ and determined tax due of \$10,755.66. The auditor added total disallowed vendor collection credits of \$95.00 to total tax due in the amount of \$21,328.68 (\$10,573.02 plus \$10,755.66), and determined total additional tax due in the amount of \$21,423.68 for the period March 1, 2009 through August 31, 2009.

The auditor did not review prepared food, cigars, coffee, or taxable household items for the period March 1, 2009 through August 31, 2009.

22. The Division subsequently issued to Majestic Deli Grocery a statement of proposed

⁴ The tax rate in effect for the months of June 2009 and July 2009 was 8.375%. However, the tax rate changed to 8.875%, effective August 2009 (*see* Chapter 200 of the Laws of 2009). The auditor divided the sum of the rates in effect for each month in the quarter ending August 31, 2009, $8.375\% + 8.375\% + 8.875\% = 25.625\%$, by 3, and determined a taxable ratio of 8.542% for the quarter ending August 31, 2009.

audit change for sales and use tax, dated May 18, 2012, asserting additional tax due of \$21,423.68 as noted above for the period March 1, 2009 through August 31, 2009, plus interest and penalty. The statement and the supporting schedules of additional tax due were sent to Ms. Antonious. However, she did not respond to these proposed audit changes for the period March 1, 2009 through August 31, 2009.

23. For the period September 1, 2009 through November 30, 2011, the auditor reviewed purchase information for the same taxable items, i.e., beer, soda, other beverages, and phone cards, and in addition, she reviewed purchases of cigars, candy, and household products. The auditor applied the markup percentage of 41.42% from the 2009 and 2010 federal income tax returns to the purchase information for those items. For cigarettes, specifically, the auditor had only seven months of purchase information from the database, and very limited information from Majestic Deli Grocery, so projections were made for 19 of the 20 months missing information.⁵ She applied an 18% markup based upon an average selling price per her survey of \$10.88, (an average of \$10.25 and \$11.50), and she allowed the prepaid cigarette tax credits, totaling \$3,906.00, reported on the sales tax returns filed for the period September 1, 2009 through November 30, 2011.

For prepared food, the auditor intended to perform an observation to determine taxable sales, but Majestic Deli Grocery and its representative refused to allow an observation. The auditor had no other information concerning prepared food sales. However, during her January 25, 2012 survey of the premises, the auditor observed four to five prepared food customers in a 15-minute period, and she had obtained a copy of the menu. To be fair, the auditor used four customers every 15 minutes, or 16 customers per hour for prepared foods. Despite the business

⁵ In each of the 19 months, the auditor projected purchases in the amount of \$16,420.00 for 1,923 packs of cigarettes. For the month of November 2010, no information or projection is listed in the auditor's supporting audit work paper entitled "Cigarette, Candy, Cigar - 3rd Party from Albany (9/1/09 - 11/30/11)."

being open 24 hours per day, based upon her audit experience, the auditor used only a two-hour period for breakfast, a three-hour period for lunch, and a three-hour period for dinner. She estimated prepared food customers for the period September 1, 2009 through November 30, 2011 (nine quarters) as follows: breakfast (4 customers every 15 minutes for 2 hours): $(4 \times 4 \times 2 \times 7$ [days] $\times 13$ [weeks] $\times 9$ [quarters]) = 26,208; lunch (4 customers every 15 minutes for 3 hours): $(4 \times 4 \times 3 \times 7 \times 13 \times 9) = 39,312$; and dinner (4 customers every 15 minutes for 3 hours): $(4 \times 4 \times 3 \times 7 \times 13 \times 9) = 39,312$. Using the selling prices of items listed on Majestic Deli Grocery's menu, the auditor computed an average selling price of \$2.90 for 21 breakfast items, and an average selling price of \$4.07 for 59 lunch/dinner items. In her computations of the average selling prices, the auditor did not include extra charges. The auditor then computed estimated taxable sales of prepared food for the period September 1, 2009 through November 30, 2011 as follows: breakfast: $26,208 \times \$2.09 = \$76,003.00$; lunch: $39,312 \times \$4.07 = \$160,000.00$; and dinner: $39,312 \times \$4.07 = \$160,000.00$.⁶

24. The computation of additional tax for the period September 1, 2009 through November 30, 2011 was made as follows: third-party purchases for beer (\$377,366.00), soda and other beverages (\$95,714.00), phone cards (\$48,021.00), and cigars, candy and other taxable items (\$8,391.00 [based upon third-party information and projections for missing quarters]) amounted to a total of \$529,492.00, to which the 41.42% markup was applied, and total sales of those items were determined to be \$748,808.00. Cigarette purchases for 26 months totaled \$422,294.00, to which an 18% markup was applied, resulting in cigarette sales of \$499,050.00 for the period September 1, 2009 through November 30, 2011. Prepared food sales for breakfast (\$76,003.00), lunch (\$160,000.00) and dinner (\$160,000.00) totaled \$396,003.00. The auditor

⁶ Daily taxable sales of prepared foods totaled \$483.52, i.e., breakfast totaled \$92.80 $(4 \times 4 \times 2 \times \$2.90)$; lunch totaled \$195.36 $(4 \times 4 \times 3 \times \$4.07)$; and dinner totaled \$195.36 $(4 \times 4 \times 3 \times \$4.07)$.

calculated total audited taxable sales in the amount of \$1,643,861.00 (\$748,808.00 + \$499,050.00 + \$396,003.00), and audited quarterly taxable sales of \$182,651.00. However, total audited taxable sales were reduced by \$2.00 to \$1,643,859.00 ($\$182,651.00 \times 9$ quarters), due to computer rounding. The auditor subtracted reported taxable sales of \$201,563.00 from \$1,643,859.00, and computed additional taxable sales in the amount of \$1,442,296.00 and tax due of \$128,003.77. She then added total disallowed vendor collection credits of \$894.00 to tax due of \$128,003.77, and determined total additional tax due in the amount of \$128,897.77 for the period September 1, 2009 through November 30, 2011.

25. The Division subsequently issued to Majestic Deli Grocery a statement of proposed audit change for sales and use tax, dated August 1, 2012, asserting additional tax due of \$128,897.77, plus interest and penalty. The auditor sent the statement and supporting audit schedules of additional tax due to Ms. Antonious.

26. No further books and records were provided to the auditor. During a September 4, 2012 telephone conversation with the auditor, Ms. Antonious verbally disagreed with the audit findings for the period September 1, 2009 through November 30, 2011.

27. The Division issued a notice of determination (L-037908929-3) to Majestic Deli Grocery, Inc., dated May 25, 2012, asserting additional sales and use taxes due in the amount of \$21,423.68 for the period March 1, 2009 through August 31, 2009, plus interest and penalties. Notice of determination (L-038579311-8), dated September 19, 2012, was also issued to Majestic Deli Grocery, Inc., asserting additional sales and use taxes due in the amount of \$128,897.77 for the period September 1, 2009 through November 30, 2011, plus interest and penalties. Each of the statutory notices assessed penalties pursuant to Tax Law § 1145 (a) (1) (i) and (vi). The penalties were imposed based upon the corporation's failure to provide sufficient books and records, and the omnibus penalty was assessed based upon the failure to report and

pay an amount in excess of 25% of the amount of tax required to be shown on the return.

28. The auditor determined Mr. Alamrani to be a responsible person of Majestic Deli Grocery for the period March 1, 2009 through November 30, 2011, because he signed the corporation's application for registration as a sales tax vendor, Ms. Antonious stated that he was the responsible person, and Mr. Alamrani signed the power of attorney on behalf of Majestic Deli Grocery.

29. The Division issued two notices of determination against Ahmed Alamrani, as an officer or responsible person of Majestic Deli Grocery, Inc. The first notice of determination (L-037915738-8), dated May 29, 2012, asserted sales and use tax due in the amount of \$21,423.68 for the period March 1, 2009 through August 31, 2009, plus interest and penalty. The second notice of determination (L-03858253-8), dated September 20, 2012, asserted sales and use tax due in the amount of \$128,897.77 for the period September 1, 2009 through November 30, 2011, plus interest and penalty. At the hearing, Mr. Alamrani conceded that he was president of Majestic Deli Grocery, signed the corporation's sales tax returns, and signed the power of attorney on behalf of the corporation. He did not contest his responsible person status for the period March 1, 2009 through November 30, 2011.

30. Petitioners filed their petitions dated April 19, 2013, contesting the notices of determination issued herein. The petitions assert that the Division arbitrarily assessed sales tax without a reasonable basis and failed to make proper adjustments. Petitioners also allege that penalties should be abated due to reasonable cause.

31. At the hearing, the auditor testified concerning the performance of the audit, the determinations made, and the basis for those determinations. She identified the initial appointment letter and the request for books and records, described the documents that were produced, and identified the documents that were not provided to her. She also detailed the

deficiencies in the records provided and explained her basis for determining that the books and records were inadequate for a detailed audit. The auditor stated that the representative never provided any information concerning sales. She noted that although deposits in the form of electronic fund transfers (EFT) by Efund Corporation resulting from food stamp purchases were shown on bank statements presented during the audit, there were no source sales documents to substantiate what items the EFT amounts represented, only the total amounts. The auditor had not reviewed nontaxable food items, and in the absence of any sales records, she was unable to determine whether taxable items, not subject to tax when purchased with food stamps, were sold. Therefore, no adjustment was made for food stamp purchases of particular items exempt pursuant to Tax Law § 1115 (k) and 20 NYCRR 528.27. The auditor acknowledged that if documentation was provided to support receipts as nontaxable, she would adjust the assessments, or make an allowance of five to ten percent on food stamp sales for nontaxable sales based upon office audit experience.

32. At the hearing, petitioners submitted Majestic Deli Grocery's checking account statements for the periods January 1, 2009 through September 30, 2011, and November 1, 2011 through November 30, 2011. Numerous direct deposits made by Efund Corporation were listed on each of these checking account statements. Petitioners also submitted a 2011 Form 1099-K, Merchant Card and Third Party Network Payments, issued by Efund Corporation to Ridgewood Convenience Deli Grocery Inc.⁷ On this form 1099-K, Efund Corporation reported the total gross amount of merchant card/third-party network payments made in 2011, and the gross amount of merchant card/third-party network payments made in each month of the calendar year.

33. The record does not include any cash register tapes, receipts, books or records that

⁷ This form 1099-K bore Majestic Deli Grocery's taxpayer identification number, Efund account number, and address.

show what items were purchased with food stamps (taxable and nontaxable) during the period March 1, 2009 through November 30, 2011.

34. During the period March 1, 2009 through November 30, 2011, Majestic Deli Grocery purchased cigarettes, cigars, candy, and other taxable household products from Amsterdam Tobacco. At the hearing, petitioners submitted a 22-page composite exhibit that included the affidavit of Marvin Gutlove, an executive of Amsterdam Tobacco, dated October 13, 2014; a 12-page Amsterdam Tobacco Summary Invoice Register, "History File 01/03/09 to 11/30/11 Active Invoices and Credit Memos" for Majestic Deli Grocery, dated January 12, 2012; eight Amsterdam Tobacco invoices issued to Majestic Deli Grocery, bearing dates between June 23, 2008 and November 21, 2008; and one Amsterdam Tobacco invoice dated June 28, 2010.

35. Mr. Gutlove's affidavit contained a summary report of Majestic Deli Grocery's purchases of cigarettes for the period March 1, 2009 through November 30, 2011. Mr. Gutlove averred that Majestic Deli Grocery's cigarette purchases totaled \$735,681.87 and prepaid cigarette sales tax paid totaled \$41,623.20 for the period March 1, 2009 through November 30, 2011. Mr. Gutlove's affidavit also listed total monthly packs purchased in each of the 33 months of the period at issue.

36. Petitioners' sole witness was petitioner Ahmed Alamrani. Mr. Alamrani conceded that he had no sales records for the period March 1, 2009 through November 30, 2011 and no records to show total sales, nontaxable sales, the taxable ratio, the selling price of items, or to determine a markup percentage for the period at issue. He claimed that the daily sales total was written on a piece of paper at the end of the day, but that paper was then discarded. Mr. Alamrani also confirmed that purchases were being made in cash.

37. At the hearing, Mr. Alamrani offered two sample cash register receipts. Each receipt is dated November 16, 2012, and although he asserted that one receipt was for cigarettes and the

other for soda, the receipts did not identify the items sold. Mr. Alamrani acknowledged that the cash register receipts do not show the particular items sold and whether they are taxable, and further, that individual receipts were not given to customers except upon request. He later admitted that that type of cash register receipt (tape) was not even used during the period March 1, 2009 through November 30, 2011.

38. At the hearing, Mr. Alamrani testified that Majestic Deli Grocery's sales tax returns did not report any cigarette sales made during the period March 1, 2009 through November 30, 2011. He claimed that his accountant's practice was not to report cigarette sales and not to claim the credit for the prepaid cigarette tax on Majestic Deli Grocery's quarterly sales tax returns. A review of such sales tax returns, however, reveals that Majestic Deli Grocery claimed credit totaling \$4,295.00 for prepaid sales tax on cigarettes during the period at issue (*see* findings of fact 20 and 23).

39. The record includes the Majestic Deli Grocery menu obtained by the auditor during the audit. Review of this menu indicates that Majestic Deli Grocery offered many items for sale including, among other items, hot prepared food, cold sandwiches, salads, cold cuts by the pound, cheese by the pound, and phone cards. At the hearing, Mr. Alamrani testified that Losito Provisions was not the supplier of certain taxable prepared food components such as eggs, rolls, bread, tuna or vegetables sold as salads.

40. At the hearing, petitioners submitted, as separate exhibits, original invoices issued to Majestic Deli Grocery by the following suppliers: Losito Provisions, Anheuser-Busch Distributors of New York, Inc. (Anheuser-Busch); Manhattan Beer Distributors (Manhattan Beer); Beehive Beer; Oak Beverages; and Pepsi-Cola (Pepsi). Each supplier's invoices bore various dates within the years 2010 and 2011, and were not in chronological order. Petitioners submitted original invoices issued to Majestic Deli Grocery by Amsterdam Tobacco that bore

dates within and without the audit period at issue, and were not in chronological order. In addition, petitioners submitted summary purchase information and reports from Losito Provisions, Manhattan Beer, Beehive Beer, Oak Beverages and Pepsi.

41. In the period between the first and second days of the hearing, the auditor was able to review petitioners' exhibits, and create a 37-page detailed analysis that was submitted into the record. All of the information in those pages of analysis was already in evidence, and part of the record. The first two pages of the auditor's analysis are bank statement information, and pages 3 through 23 list suppliers' invoices submitted into evidence at the hearing by petitioners. Those invoices were issued by Losito Provisions, Beehive Beer, Manhattan Beer, Oak Beverage, Anheuser-Busch, Pepsi, and Amsterdam Tobacco. Page 24 of the analysis is a comparison table. The first column of the comparison table lists invoices provided by petitioners at the hearing. The second column lists the third-party information that the Division obtained, with projections for missing information, as compiled during the audit. The third column consists of information in the statements and summaries provided by Majestic Deli Grocery's suppliers, in evidence at the hearing. The auditor stated that a comparison between column 2 (information used on audit) and column 3 (Majestic Deli Grocery's suppliers' summaries) of the comparison table reveals a significant difference between the purchase information the Division used during the audit, and petitioners' own evidence. Specifically, that Majestic Deli Grocery's suppliers report purchases in excess of the purchase amounts used by the auditor in her markup audit. The auditor stated that this fact indicated that the Division had underassessed tax.

42. A review of the Amsterdam Tobacco invoices submitted in evidence at the hearing and the auditor's analysis of those invoices shows that Amsterdam Tobacco itemized and charged Majestic Deli Grocery "prepaid cigarette tax" on every purchase of cigarettes during the period at issue. A statement on each invoice provides that Amsterdam Tobacco is a New York

State stamping agent (agent number 115) and is passing the “pre-collected sales tax” through to the buyer. Each invoice also lists the amount of prepaid sales tax per carton. The auditor’s analysis of the Amsterdam Tobacco invoices submitted in evidence at the hearing that bear dates within the audit period indicates that such invoices charged a total of \$37,731.81 in prepaid cigarette tax.

43. As noted, the Division determined additional tax due on cigarette sales by using a purchase markup method. In performing this part of the audit, the Division used third-party purchase information for the 12 months of the 33-month audit period that such information was available to calculate Majestic Deli Grocery’s monthly cigarette purchases by cost and by quantity (i.e., number of packages purchased). The Division then calculated the average of such monthly figures and applied such monthly averages to each of the remaining 19 months of the audit to estimate the cost and quantity of cigarette purchases for those months.⁸ The documents submitted in evidence as the audit report (exhibit K) include the auditor’s work papers. Those work papers list Majestic Deli Grocery’s monthly purchases of cigarettes determined as noted. The number of packages of cigarettes purchased per month are listed under the heading “Cig Qty” in exhibit K on pages 98 and 100.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge found that the Division’s requests to review Majestic Deli Grocery’s records were sufficient; that the records provided in response to those requests were completely reviewed; that such records were insufficient for the purpose of substantiating Majestic Deli Grocery’s sales; and that, accordingly, the Division properly estimated Majestic Deli Grocery’s sales tax liability in this case.

⁸ For unexplained reasons, two months within the audit period (August 2009 and November 2010) were not included in the audit of cigarette sales.

In reaching this conclusion, the Administrative Law Judge specifically rejected petitioners' contention that the auditor failed to adequately review all of Majestic Deli Grocery's available records before resorting to the use of third-party purchase information.

As to the Division's conduct of the audit, the Administrative Law Judge determined that the audit markup on purchases of beer and nonalcoholic beverages, using the average ratio of gross profit to cost of goods sold as reported on Majestic Deli Grocery's federal income tax returns for the years 2009 and 2010, was reasonable. The Administrative Law Judge also concluded that the audit markup on cigarette purchases using Publication 509 was reasonable and that petitioners' argument that such publication requires a lower markup was without merit.

With respect to audited sales of prepared food, the Administrative Law Judge dismissed petitioners' contention that the survey upon which such audited sales were based was unreasonably flawed. Instead, the Administrative Law Judge concluded that, under the circumstances, the Division's estimate of prepared food sales was reasonable.

The Administrative Law Judge also concluded that petitioners did not substantiate an adjustment for additional credit for prepaid cigarette tax. The Administrative Law Judge found no evidence in the record linking Majestic Deli Grocery's Amsterdam Tobacco purchases indicated by the invoices submitted at the hearing to any sales of cigarettes during the audit period. Without evidence of such sales, the Administrative Law Judge saw no basis for additional credit.

The Administrative Law Judge rejected petitioners' argument for an adjustment to the audit results for tax exempt food stamp sales. Given the absence of any sales records, the Administrative Law Judge found no evidence to show what items were purchased using food stamps. The Administrative Law Judge concluded that the EFT records in evidence contain no

information to show the taxability of any particular sale.

The Administrative Law Judge thus concluded that the Division's audit method was reasonable and that petitioners did not meet their burden to show that such method was unreasonable or that the results were unreasonably inaccurate.

The Administrative Law Judge sustained the penalties imposed in the statutory notices. The Administrative Law Judge found that petitioners did not prove that their failure to report and remit the proper sales tax was due to reasonable cause and not due to willful neglect.

SUMMARY OF ARGUMENTS ON EXCEPTION

Petitioners raise the same issues on exception as they raised below.

Petitioners concede that Majestic Deli Grocery's records were insufficient and that, therefore, the Division had the right to use external indices to estimate sales tax liability. Notwithstanding this record keeping failure, petitioners argue that the Division had an obligation to review all of the records that were made available and that the Division failed to meet this obligation during the audit. Petitioners specifically contest the Administrative Law Judge's factual findings that the auditor reviewed all purchase records that were provided on audit. According to petitioners, the auditor did not review all of the records that were so provided and, therefore, the auditor's conclusion that such records were incomplete was premature. Petitioners argue that this failure to review all of the records provided on audit was a fundamental error that led to the following additional errors: a failure to account for prepaid sales tax on cigarettes and exempt food stamp sales; the improper use of a survey to assess tax on prepared food sales; and the use of inappropriate markups. Petitioners contend that all of these errors, taken together, render the audit methodology irrational and require the cancelation of the notices of determination.

Alternatively, and short of cancelation, petitioners assert that the deficiencies should be adjusted to account for the above-noted errors. Specifically, petitioners contend that they should be provided additional credit for prepaid cigarette tax. They assert that the invoices in the record indicate that Majestic Deli Grocery paid \$41,623.00 in such prepaid tax to Amsterdam Tobacco and that the subject assessments should be credited accordingly.

Petitioners also seek an allowance for prepared food sales paid with food stamps. Petitioners contend that, according to Mr. Alamrani's testimony, 50% of Majestic Deli Grocery's sales of prepared food were purchased with food stamps and thus are tax-exempt. Petitioners note that the auditor herself indicated in her testimony that an allowance of five to ten percent for food stamp sales was reasonable.

Petitioners also contend that the audit method employed to calculate additional tax due on prepared food sales was unreasonable. Petitioners argue that the survey used to assess tax on prepared food was based on data that was neither reliable nor sufficient. They contend that the 15-minute survey that forms the basis for this component of the assessment was chosen in retaliation for petitioners' objection to an observation test. Petitioners assert that sufficient purchase records were provided on audit for the Division to compute a reasonable assessment for prepared food sales.

Petitioners continue to protest the markup computed and applied by the Division in its audit of cigarette purchases for the March 1, 2009 through August 31, 2009 period. Petitioners assert that the auditor misused the Division's Publication 509 in computing cigarette markups for this period. Noting Mr. Alamrani's testimony that Majestic Deli Grocery made little profit on cigarettes due to high cigarette taxes, petitioners contend that the minimum markup of 7% as indicated in Publication 509 should have been used. Petitioners also object to the markup on

cigarette purchases for the September 1, 2009 through November 30, 2011 period, where the Division used posted prices for cigarettes obtained during the January 25, 2012 survey. Again, petitioners assert that the minimum markup of 7% should have been used.

Additionally, petitioners continue to argue that the markup on beer, soda, and other beverages was erroneous. Petitioners assert that this markup, computed using Majestic Deli Grocery's reported gross sales and cost of goods sold for 2009 and 2010, was inflated with respect to these items because it included both taxable and nontaxable sales. According to petitioners, nontaxable sales generally have a larger markup. Citing Mr. Alamrani's testimony, petitioners contend that beer was a non-revenue producing item for Majestic Deli Grocery. Petitioners also note that the markup does not account for free sodas that were provided with certain prepared food purchases. Petitioners contend that the record contains sufficient information to compute reasonable markups of 20% and 38% for beer and soda, respectively. Additionally, petitioners assert that use of the markup derived from the federal income tax returns is unreasonable because the Division has determined in its audit herein that Majestic Deli Grocery's actual cost of goods sold (according to third-party purchase information) is substantially greater than the amounts reported on its returns. Accordingly, a markup based on the reported amounts is necessarily inaccurate.

Finally, petitioners continue to seek abatement of penalties, arguing that any underreporting of sales tax by Majestic Deli Grocery was due to reasonable cause and not due to any willful neglect.

On exception, petitioners also contend that the Division applied the incorrect sales tax rate in computing tax due for the first audit period (March 1, 2009 through August 31, 2009).

The Division asserts that it made a proper request for Majestic Deli Grocery's books and

records; that it properly determined that the records so provided were insufficient; and that it was therefore authorized to use an indirect audit method to determine Majestic Deli Grocery's sales tax liability. The Division contends that the method so employed was reasonable.

Specifically, the Division argues that its use of a markup derived from the corporation's 2009 and 2010 income tax returns to determine audited taxable sales of phone cards, beer, nonalcoholic beverages, cigars, candy, and household products, was reasonable under the circumstances. The Division argues that petitioners provided no sales records to show a more exact overall markup or any markup on specific items.

The Division also contends that its determination of tax on sales of prepared food was reasonable. The Division argues that a markup on cold cut purchase invoices was unfeasible for several reasons. First, the Division asserts that the cold cut invoices provided on audit were incomplete, as none were provided for three of the sales tax quarters of the audit period. Second, the completeness of the provided invoices could not be checked against a purchase journal or general ledger, as Majestic Deli Grocery did not maintain such a journal or ledger. Third, the purchase invoices provide no information regarding the number of sandwiches sold or the amount of meat or cheese per sandwich, both of which would be important elements of a purchase markup of cold cut purchases for a delicatessen. The Division thus asserts that its proposed observation test would have been reasonable, but given petitioners' objection to such a test, it used the information that was available, i.e., the auditor's survey, the store's menu, and the auditor's experience to estimate prepared food sales. The Division asserts further that this method was not retaliatory, as petitioners contend.

The Division also contends that petitioners did not present sufficient evidence to make an adjustment to taxable audited prepared food sales for food stamp-exempt purchases.

With respect to cigarette sales, the Division asserts the cigarette purchase invoices provided on audit were incomplete and that, accordingly, it properly used the third-party purchase information in its database and properly made projections where such third-party information was not available. The Division also contends that it reasonably determined an average selling price for cigarettes using Publication 509 for the first audit period and petitioner's posted prices for the second audit period.

The Division claims that petitioners did not prove entitlement to prepaid sales tax on cigarettes beyond the amount reported on Majestic Deli Grocery's sales tax returns. The Division asserts that petitioners have offered no sales records to link Majestic Deli Grocery's purchases of cigarettes to any sales of cigarettes. The Division argues that such a link is necessary to prove entitlement to the claimed credit. The Division notes that the cigarette purchase invoices submitted in evidence at the hearing and the summary of such purchases also submitted at the hearing differ significantly from each other in the total amount of cigarette purchases and that both are significantly greater in amount than audited cigarette purchases. Given this inconsistency, and the fact that such documents were not produced on audit, the Division suggests that they should be given little weight herein. In order to provide the credit that petitioners claim, the Division asserts that audited cigarette sales (and the tax due thereon) would have to be increased accordingly. The Division also suggests that the cigarette purchase invoices introduced at the hearing may indicate something other than a purchase for resale by Majestic Deli Grocery, such as purchases made on behalf of another retailer.

The Division also contends that petitioners have failed to prove reasonable cause for the abatement of penalties.

On the sales tax rate issue raised by petitioners on exception, the Division states that it

used the prevailing rate for the March 1, 2009 through May 31, 2009 period and that it used an average of the prevailing rates for the June 1, 2009 through August 31, 2009 period because the sales tax rate changed as of August 1, 2009.

OPINION

The Division asserted additional tax due on Majestic Deli Grocery's retail sales of beer, soda, other beverages, cigarettes, cigars, candy, and household items, all taxable under Tax Law § 1105 (a); prepaid phone cards, taxable under Tax Law § 1105 (b) (1) (D); and prepared food, taxable under Tax Law § 1105 (d).⁹

Persons required to collect tax on such sales, including both of the petitioners herein, must “keep records of every sale . . . in such form as the commissioner of taxation and finance may by regulation require” (Tax Law § 1135 [a] [1]). Required sales records include copies of each “guest check . . . cash register tape and any other original sales document” (20 NYCRR 533.2 [b] [1]). These records must be sufficient to verify all transactions; kept in a manner suitable to determine the correct amount of tax due; and available for the Division's inspection upon request for a period of three years (Tax Law § 1135 [g]; 20 NYCRR 533.2 [a] [1], [2]).

Tax Law § 1138 (a) (1) provides, in relevant part, that if a sales tax return is not filed, “or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices” The standard for the use of external indices (also referred to as an indirect or an estimated audit) is well established. The Division must first make an explicit request for the taxpayer's books and records (*Matter of Christ Cella, Inc. v*

⁹ Petitioners' exception does not contest the Division's assertion of additional tax due on sales of phone cards, cigars, candy, and household items. Accordingly, this decision does not address the Division's audit method or result with respect to any of these items.

State Tax Commn., 102 AD2d 352 [1984]) for the entire period of the assessment (*Matter of Adamides v Chu*, 134 AD2d 776 [1987], *lv denied* 71 NY2d 806 [1988]). The Division must then make a thorough review of such records (*Matter of King Crab Rest. v Chu*, 134 AD2d 51 [1987]). If such review indicates that the records are insufficient for the Division to verify taxable sales receipts and conduct a complete audit from which the exact amount of tax due can be determined, then the use of external indices is proper (*Matter of Giordano v State Tax Commn.*, 145 AD2d 726, 727 [1988]).

Applying the foregoing principles to the facts herein makes clear that the Division's use of an indirect audit method was proper. The Division made both written and oral requests for Majestic Deli Grocery's records for the entire audit period (*see* findings of fact 5 and 12). There is no dispute that Majestic Deli Grocery did not maintain or make available any records of its sales. That is, neither cash register tapes, guest checks, sales receipts, a day book nor a general ledger were provided. A failure to maintain or to make available any sales records justifies a resort to an indirect audit method (*see Matter of Coram Diner Corp.*, Tax Appeals Tribunal, March 12, 2015).

Adequacy of Division's review of records

Contrary to petitioners' contention, we concur in the Administrative Law Judge's conclusion that the Division's auditor thoroughly reviewed the purchase records provided by petitioners' representative on audit, as required (*see* finding of fact 11). We note that the Administrative Law Judge specifically found that the auditor "credibly testified" that she saw many of the purchase invoices submitted in evidence and all of the summary information and reports from suppliers for the first time at the hearing. This Tribunal has consistently deferred findings of witness credibility to the Administrative Law Judge, who, as the finder of fact, has

the opportunity to observe witnesses and to evaluate the truthfulness of their testimony (*see Matter of Spallina*, Tax Appeals Tribunal, February 27, 1992). We see no compelling reason to disturb this particular credibility finding.

We note further that the auditor's audit log provides support to her testimony. Specifically, the March 19, 2012 entry indicates that the auditor reviewed "available merchandise purchase invoices" and that the vendor "provided incomplete purchase invoices for the entire audit period." The April 20, 2012 entry summarizes a telephone call between the auditor and petitioners' representative, in part: "vendor did not provide auditable condition cig. purchases at the first appt."

Petitioners' argument to the contrary on this point is premised solely on the circumstantial fact that the auditor did not transcribe all of the invoices that she reviewed at the March 19, 2012 field audit appointment. Such indirect evidence is insufficient to establish petitioners' factual claim, given the auditor's credible testimony and the tax field audit record entries, as noted, and the lack of any other evidence in the record supporting petitioners' claim.

The purchase markups

Where, as here, the Division is authorized to estimate taxable sales, such method must be reasonably calculated to reflect the taxes due (*Matter of Ristorante Puglia, Ltd. v Chu*, 102 AD2d 348, 350 [1984]), but exactness is not required (*Matter of Markowitz v State Tax Commn.*, 54 AD2d 1023 [1976], *affd* 44 NY2d 684 [1978]). Under such circumstances, any imprecision in the audit results is a consequence of the taxpayer's failure to maintain books and records as required under Tax Law § 1135 (a) (1) and must be borne by the taxpayer (*see Matter of Constantini*, Tax Appeals Tribunal, January 10, 2008). The taxpayer bears the burden of proving, by clear and convincing evidence, that the audit method was unreasonable or the amount

of the assessment is unreasonably inaccurate (*see Matter of Meskouris Bros. v Chu*, 139 AD2d 813 [1988]). In addition, while considerable latitude is given to the audit method selected, there must be sufficient evidence in the record to conclude that the method has a rational basis (*Matter of Grecian Sq. v New York State Tax Commn.*, 119 AD2d 948, 950 [1986]).

The Division used a purchase markup method to determine Majestic Deli Grocery's taxable sales of beer, soda and other beverages, and cigarettes. The use of third-party purchase information to estimate sales tax liability is well established as an acceptable indirect audit method (*see e.g. Matter of Roebing Liqs. v Commissioner of Taxation & Fin.*, 284 AD2d 669 [2001], *lv dismissed* 97 NY2d 637 [2001], *cert denied* 537 US 816 [2002]; *Matter of Lima*, Tax Appeals Tribunal, April 19, 2007). Given the state of Majestic Deli Grocery's records, we find the Division's use of such a method here to be reasonable.

We also find that the markup percentages used by the Division in calculating taxable sales of beer, soda and other beverages, and cigarettes were reasonable, and that petitioners have not met their burden to show that such markup percentages were unreasonably inaccurate (*see Matter of Meskouris Bros. v Chu.*).

In determining tax due on sales of beer, soda, and other beverages, the Division used a markup percentage of 41.42% based on Majestic Deli Grocery's gross receipts and cost of goods sold as reported on its 2009 and 2010 federal income tax returns. Petitioners' assertion that this overall markup percentage is high because it also includes nontaxable sales is without substantiation in the record. We also find, contrary to petitioners' claim, that the record does not support a finding that beer and soda purchases were marked up 20% and 38%, respectively. This claim is unsupported by any documentation related to the period at issue and rests largely upon the testimony of Mr. Alamrani. The Administrative Law Judge characterized such testimony as

“vague” and we agree with that characterization.

In addition, we disagree with petitioners’ contention that it was improper for the Division to use a markup based on Majestic Deli Grocery’s federal income tax returns because the third-party purchase information obtained during the audit shows that those returns grossly under report Majestic Deli Grocery’s cost of goods sold. Considering Majestic Deli Grocery’s many record keeping failures, we think that the Division reasonably relied on the markup as reported on the federal returns, even though the audit indicates significant underreporting on those returns. The Division’s use of the reported markup simply presumes that the additional purchases found through third-party information were sold at the same markup as the reported purchases. Under the circumstances, we find that this is a reasonable audit presumption and we note that petitioners have offered nothing to refute it.

The Division marked up Majestic Deli Grocery’s cigarette purchases for the period March 1, 2009 through August 31, 2009 using the highest price per package listed in the Division’s Publication 509 for cigarette sales within New York City as Majestic Deli Grocery’s retail price (*see* finding of fact 20). As noted, petitioners contend that the Division misused Publication 509 and further contend that the Division should have used the 7% minimum markup referenced therein. We disagree. The external index in question, Publication 509, was clearly identified in the record as required and thereby establishes a rational basis for its use (*see e.g. Matter of Staekeler*, Tax Appeals Tribunal, November 23, 2005). We have previously determined that the use of a similar publication to estimate cigarette sales was reasonable (*see Matter of Ahmed*, Tax Appeals Tribunal, April 14, 2011). Moreover, we agree with the Administrative Law Judge that petitioners did not meet their burden to show that such audited retail price was erroneous. As to petitioners’ contention that the Division should have used the minimum markup of 7% as

referenced in Publication 509, we note that the Division is “not under an obligation to use an external index in such a way as to minimize petitioners’ tax liability,” but must simply use such an index in a manner reasonably calculated to reflect tax due (*Matter of 33 Virginia Place, Inc.*, Tax Appeals Tribunal, March 31, 2011). As discussed, the Division’s use of Publication 509 in this case meets this obligation.

We reach the same conclusion with respect to the markup of 18% on audited cigarette purchases for the September 1, 2009 through November 30, 2011 period. That is, we find that the Division’s use of this markup percentage was reasonable and that petitioners have failed to prove that it was unreasonably inaccurate.

Additional credit for prepaid sales tax on cigarettes

Prepaid sales tax on cigarettes is imposed pursuant to Tax Law § 1103. Our review of the cigarette purchase invoices submitted at the hearing, as well as the auditor’s analysis of those invoices, reveals that prepaid sales tax on cigarettes was passed through to Majestic Deli Grocery by its supplier on all of Majestic Deli Grocery’s cigarette purchases during the audit period for which an invoice was submitted (*see* findings of fact 41 and 42). Further, the total amount of purchases indicated by the submitted invoices exceeds total audited cigarette purchases.

Additionally, we note that the cigarette purchase invoices itemize the amount of prepaid tax charged to Majestic Deli Grocery; list the per carton amount of prepaid sales tax; identify the seller as a stamping agent; list the agent’s identification number; and indicate that the prepaid sales tax was being passed through to the purchaser. The invoices are thus in substantial compliance with the requirements of the Division’s certificate of prepayment of sales tax on cigarettes (form ST-133). Accordingly, we find that petitioners have established that Majestic Deli Grocery paid appropriate prepaid sales tax to Amsterdam Tobacco on Majestic Deli

Grocery's purchases of cigarettes during the period at issue.

A retailer is entitled to a credit for such prepaid sales tax upon its collection and remission of sales tax imposed pursuant to Tax Law § 1105 (a) following a retail sale to a customer (*see* "Prepaid Sales Tax on Cigarettes" TSB-M 95 [7] S [August 1, 1995]). Here, the Division determined on audit that Majestic Deli Grocery made retail sales of cigarettes of \$105,032.00 for the period March 1, 2009 through August 31, 2009 and \$499,050.00 for the period September 1, 2009 through November 30, 2011. As Majestic Deli Grocery has established that it properly paid prepaid sales tax on its cigarette purchases, we find that it is entitled to credit for such prepaid tax on its cigarette sales as determined on audit.

The Division is thus directed to provide such credit in accordance with Majestic Deli Grocery's monthly purchases of packages of cigarettes as indicated in the audit work papers at pages 98 and 100 of exhibit K and the per package prepaid sales tax amounts in effect at the time such packages were purchased by Majestic Deli Grocery (*see* NY ST Dept of Taxation & Fin Important Notice ["Important Notice Regarding Prepaid Sales Tax on Cigarettes"], notice numbers N-08-9 [July 2008], N-09-13 [July 2009], N-10-5 [July 2010], and N-11-5 [August 2011]). Additionally, the Division is directed to presume that all such cigarette packages purchased by Majestic Deli Grocery were packages of 20 cigarettes, given the lack of evidence on this point in the record. We note that the amount of credit for prepaid sales tax on cigarettes previously claimed and granted should be subtracted from the amount of such credit determined in accordance with this paragraph to calculate the amount of the adjustment for such credit reflected in the statutory notices.

Petitioners are not entitled to any credit for prepaid sales tax on cigarettes in excess of cigarette purchases as determined on audit. As noted, collection and payment of sales tax on a

retail sale is a prerequisite to any such credit. There is no evidence in the record that Majestic Deli Grocery collected and paid sales tax on retail sales of any purchases of cigarettes from Amsterdam Tobacco in excess of audited purchases. Clearly, such excess purchases were not included in audited taxable sales herein.

In arguing against any credit for prepaid sales tax on cigarettes beyond the amount claimed on Majestic Deli Grocery's sales tax returns, the Division notes the lack of any sales records linking Majestic Deli Grocery's purchases of cigarettes to any sales of cigarettes by Majestic Deli Grocery. We disagree. Majestic Deli Grocery's cigarette purchases are linked to its sales of cigarettes by the audit itself. The purchase markup audit method uses Majestic Deli Grocery's purchases as the basis for estimating its sales by presuming that all such purchases were sold. As noted, the record shows that Majestic Deli Grocery paid prepaid sales tax on its purchases of cigarettes. This decision reasonably allows credit for such prepaid tax on cigarette purchases to the extent of Majestic Deli Grocery's sales of those cigarettes as determined on audit. We observe that, although not part of our holding in that case, the audit in *Matter of 88-02 Deli Grocery Corp.* (Tax Appeals Tribunal, September 13, 2012), cited by the Division in support of its position on this point, allowed credit for prepaid sales tax on cigarettes to the extent of sales as estimated by an observation test. Additionally, and similar to the present matter, our holding in that case effectively denied any additional credit for prepaid sales tax in excess of credit attributable to audited sales.

Prepared food sales

The Division's estimate of prepared food sales is premised on the extrapolation of the "4-5" of such sales observed by the auditor during her 15-minute survey of Majestic Deli Grocery on

January 25, 2012 over the 27-month “second” audit period (*see* finding of fact 23)¹⁰. Although not characterized as such by the Division, this is plainly an observation test methodology. While the use of a one-day observation test to project sales over a multi-year audit period has been sustained as a reasonable means of estimating taxable sales in many cases (*see e.g., Matter of Edelweiss Catering, Inc.*, Tax Appeals Tribunal, December 16, 2016) [11-hour observation test]), we find that this particular observation test is fatally flawed. Specifically, the 15-minute duration of the test herein is a small fraction of the duration of any observation test sustained by this Tribunal or the courts that we have been able to discover in our research (*cf. e.g. Matter of Staekeler* [10-hour observation test]; *Matter of Marte*, Tax appeals Tribunal, August 5, 2004 [10-hour observation test]; *Matter of Club Marakesh, Inc.*, State Tax Commn., February 20, 1987, *confirmed sub nom Matter of Club Marakesh v Tax Commn. of State of N.Y.*, 151 AD2d 908 [1989], *lv denied* 71 NY2D 616 [1989] [6.5-hour observation test]). While an observation test need not “compute the tax owed with a high degree of precision or be held to ensure that the amount arrived at accords with statistical norms” (*Matter of Meskouris Bros. v Chu*, 139 AD2d at 814 [2-day, 15-hour observation test]), we find it unreasonable that the fleeting glimpse of business activity afforded by the auditor’s 15-minute observation serves as the basis for the Division’s 27-month audit of prepared food sales. We thus conclude that the audit method used to estimate Majestic Deli Grocery’s sales of prepared food was not reasonably calculated to reflect tax due.

Where a sales tax method is shown to be unreasonable, the taxpayer need not prove the proper amount of the assessment (*see e.g. Matter of Paladino*, Tax Appeals Tribunal, June 30,

¹⁰ While the use of this method was obviously in response to petitioners’ refusal to allow the Division to conduct a full observation test on the store’s premises (*see* finding of fact 23), we find no evidence to support petitioners’ contention that this method was selected in retaliation for that refusal.

1994). The Division is therefore directed to adjust the sales tax deficiencies herein for the period September 1, 2009 through November 30, 2011 by eliminating from such deficiencies sales tax asserted on Majestic Deli Grocery's sales of prepared food.

In reaching the foregoing conclusion, we necessarily disagree with the Division's argument that the audit method used to estimate prepared food sales was "forced" upon it by petitioners and was therefore reasonable. The Division cites petitioners' refusal to allow an in-store observation, the lack of any sales records and the lack of complete purchase records in support of its argument. While the state of a taxpayer's available records has been cited as a factor justifying the use of an observation test (*see Matter of Mera Delicatessen, Inc.*, Tax Appeals Tribunal, November 2, 1989 ["observation test virtually the only means available to the Division to estimate tax liability"]), it does not appear to us that the method chosen here to estimate prepared food sales was the only method available. We note that the auditor's preliminary computations of additional tax due used a purchase markup method (*see* finding of fact 13). While the record shows that the invoices that served as the basis for this abandoned purchase markup were incomplete, and while there are certainly complicating factors that arise with such an audit (e.g., portion sizes, nontaxable sales by the pound), such purchase invoices would seem to provide a significantly firmer foundation for an estimate than the cursory observation that was ultimately used.

Prepared food sales exempt as food stamp sales

Our conclusion regarding the prepared food portion of the audit renders moot petitioners' contention that an adjustment should be made for food stamp purchases of prepared food.

Penalties

Penalties were asserted against petitioners pursuant to Tax Law § 1145 (a) (1) (i) and (vi).

Tax Law § 1145 (a) (1) (i) states that any person failing to file a return or pay over any sales or use tax “shall” be subject to a penalty. Tax Law § 1145 (a) (1) (vi) states that any person who omits from the total amount of tax required to be shown on a sales tax return an amount which is in excess of 25 percent of such total amount “shall be subject to a penalty equal to ten percent of the amount of such omission.” Both such penalties must be sustained unless the failure was due to reasonable cause and not willful neglect (*see* Tax Law § 1145 [a] [1] [iii]).

We find that the record clearly shows willful neglect on the part of petitioners. Majestic Deli Grocery failed to maintain *any* sales records for the period at issue in clear contravention of Tax Law § 1135 (a). Further, even with the adjustments to the audit results determined herein, Majestic Deli Grocery consistently and substantially under reported its taxable sales throughout the period at issue. Additionally, we agree with the Administrative Law Judge’s finding that the record does not support petitioners’ claim that Mr. Alamrani acted in good faith and simply misunderstood the law with respect to the proper reporting of cigarette sales (*see* finding of fact 38). We thus sustain the penalties asserted in the notices of determination.

Sales tax rate

Petitioners’ contention that the Division used an incorrect sales tax rate for the March 1, 2009 through August 31, 2009 period is without merit. The Division’s use of an average rate for the period in which the rate changed was reasonable (*see* finding of fact 21).

Accordingly, its is ORDERED, ADJUDGED and DECREED that:

1. The exception of Majestic Deli Grocery, Inc., and Ahmed Alamrani is granted to the extent indicated in paragraph 4 below, but is in all other respects denied;
2. The determination of the Administrative Law Judge is modified to the extent indicated in paragraph 4 below, but is in all other respects affirmed;

3. The petitions of Majestic Deli Grocery, Inc., and Ahmed Alamrani are granted to the extent indicated in paragraph 4 below, but are in all other respects denied; and

4. The notices of determination dated May, 25, 2012, May 29, 2012, September 19, 2012, and September 20, 2012 are modified to allow appropriate credit for prepaid sales tax on cigarettes to the extent of Majestic Deli Grocery's audited sales of cigarettes as more specifically provided in this decision; the notices of determination dated September 19, 2012 and September 20, 2012 are further modified to exclude from the computation of tax due the results of the audit of prepared food sales as provided in this decision; and as so modified, the notices of determination dated May 25, 2012, May 29, 2012, September 19, 2012, and September 20, 2012 are sustained.

DATED: Albany, New York
April 14, 2017

/s/ Roberta Moseley Nero
Roberta Moseley Nero
President

/s/ James H. Tully, Jr.
James H. Tully, Jr.
Commissioner

/s/ Dierdre K. Scozzafava
Dierdre K. Scozzafava
Commissioner