

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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In the Matter of the Petitions	:	
of	:	
<b>EDELWEISS CATERING, INC.</b>	:	DECISION
	:	DTA NOS. 825911
	:	AND 825963
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, 2005 through February 29, 2012.	:	

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Petitioner, Edelweiss Catering, Inc., filed an exception to the determination of the Administrative Law Judge issued on November 12, 2015. Petitioner appeared by its president, Juergen Staeckeler. The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K. Jack, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a letter brief in opposition. Petitioner filed a reply brief. Oral argument was heard on June 16, 2016, in New York, New York, which date began the six-month period for 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 clearly requested and, in turn, received from the petitioner books and records that were sufficient for the conduct of a direct audit.

II. Whether, if sufficient books and records were not provided, petitioner has nonetheless established that the indirect audit methodology utilized by the Division of Taxation was not

reasonably calculated to reflect the correct amount of tax due, or that there were errors made in the application of such audit methodology.

### ***FINDINGS OF FACT***

We find the facts as determined by the Administrative Law Judge. Such facts are set forth below.

1. Petitioner, Edelweiss Catering, Inc., operated a delicatessen located in Yaphank, New York, during the period March 1, 2005 through February 29, 2012. Petitioner sold hot and cold prepared food, sandwiches, wraps, salad dishes, pastries, chips, snacks and beverages.

Petitioner's premises are located inside a free-standing building and include a pastry display, four chip racks, a large cold salad case, a four-door refrigerator for beer, a seven-door refrigerator for other cold beverages and five chafing (steam) tables for hot foods. There were two tables with benches located outside of the premises, but no inside seating. Food delivery was available, and the deli also provided catering. Petitioner was open seven days per week between the hours of 6:00 A.M and 5:00 P.M. on Monday through Friday, 7:00 A.M. and 3:00 P.M. on Saturdays and 7:00 A.M. to 2:00 P.M. on Sundays. Petitioner filed its sales and use tax returns on a quarterly basis.

2. There are two audit periods at issue in this matter, and each will be discussed in turn.

#### The First Audit Period - March 1, 2005 through November 30, 2007<sup>1</sup>

3. By an appointment letter dated January 29, 2008, the Division of Taxation (Division) notified petitioner that its New York State sales and use tax records had been scheduled for a field audit for the period March 1, 2005 through November 30, 2007 (the first audit period).

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<sup>1</sup> By an order dated July 31, 2014, an initial challenge to the timeliness of the petition filed for this period was resolved in petitioner's favor.

The Division's audit appointment letter explained that all books and records pertaining to petitioner's sales and use tax liability for the noted period must be available on the audit appointment date of February 26, 2008. Among the records specifically requested, in an attached records requested list, were sales tax returns, worksheets and cancelled 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/sales invoices; expense purchase invoices; merchandise purchase invoices; bank statements, canceled checks and deposit slips for all accounts; cash receipts journal and sales journal; cash disbursements journal and purchase journal; the corporate book, including minutes, board of directors and articles of incorporation; depreciation schedules; copies of leases; SLA license; lease contracts; utility bills; guest checks; and cash register tapes for the entire audit period.

4. In response to the foregoing, petitioner's then-representative provided to the auditor petitioner's accountant's worksheets listing monthly gross receipts, cash payroll and total receipts, and petitioner's daybook sheets listing daily sales receipts (excluding cash register tapes). Subsequently, petitioner's then-representative provided a few cash register tapes. The type of cash registers used by petitioner do not identify or describe the individual items being sold, but rather only indicate the dollar amount of the sale and whether the sale is rung into the register as taxable or nontaxable.

5. The auditor's review of the foregoing documents confirmed that petitioner did not maintain detailed records of its sales, including detailed cash register tapes or other source documents identifying individual sales or items sold, or the taxable versus nontaxable status of any of such individual items. Accordingly, the auditor concluded that the books and records

were inadequate to conduct a complete audit so as to verify gross sales or the taxable status of any of petitioner's sales. The auditor sent correspondence to petitioner dated July 25, 2008, informing petitioner that its books and records were insufficient and that it would be necessary to perform a full-day observation at petitioner's premises.

6. The Division's auditor performed an observation of the deli's sales on Thursday, August 7, 2008. The observation began at the opening of the deli at 6:00 A.M. and continued until the deli's closing at 5:00 P.M. According to the Division's audit report, the observation test disclosed total gross receipts for the day of \$2,468.22, consisting of total taxable sales in the amount of \$1,982.52 and nontaxable sales of \$485.70.<sup>2</sup> The auditor reduced total taxable sales by the amount of sales tax included therein to arrive at net taxable sales of \$1,825.10, which together with nontaxable sales (\$485.70), resulted in adjusted gross sales of \$2,310.80. In turn, the auditor compared taxable sales (\$1,825.10) to adjusted gross sales (\$2,310.80), to arrive a taxable sales ratio of 78.98%.

7. The auditor multiplied petitioner's audited net taxable sales per the observation results (\$1,825.10) by 91 days per sales tax quarterly period, and in turn multiplied the resulting quarterly net taxable sales amount by the 11 quarterly periods within the subject audit period, to arrive at audited taxable sales of \$1,826,925.10. The auditor reduced such amount by taxable sales reported per petitioner's sales and use tax returns (\$637,073.00), to arrive at additional taxable sales of \$1,189,852.10, with sales tax due thereon in the amount of \$102,224.21.

8. On March 2, 2009, the Division issued to petitioner a notice of determination assessing additional sales and use tax due for the period March 1, 2005 through November 30, 2007 in the amount of \$102,224.21, plus interest and penalty.

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<sup>2</sup> Notwithstanding the auditor's observation that patrons placed catering orders on the date of the observation, the Division did not include any amounts for catering sales in its computation of total sales.

The Second Audit Period - December 1, 2007 through February 29, 2012

9. By letters dated September 2, 2010, addressed to petitioner, and December 9, 2010, addressed to petitioner's then-representative, the Division notified petitioner that its New York State sales and use tax records had been scheduled for a field audit for the period December 1, 2007 through May 31, 2010. This period was thereafter extended to February 29, 2012 (the second audit period).<sup>3</sup> As was the case with the first audit period, the Division's audit appointment letters explained that all books and records pertaining to petitioner's sales and use tax liability for the audit period must be made available for audit and, as before, included an attached records requested list specifying such records (*see* finding of fact 3).

10. In response to the foregoing, petitioner's then-representative met with the auditor on February 15, 2011 and provided petitioner's bank statements and general ledger for a portion of the audit period (2008 and 2009), plus three boxes of purchase invoices that were reviewed but deemed by the auditor not to be in auditable condition. No cash register tapes or other documents concerning petitioner's sales were provided. The auditor provided petitioner's then-representative with a list of items needed to complete the audit.

11. Between July 2011 and September 2011, three boxes of rolls of cash register tapes pertaining to the second audit period, and one box of rolls of cash register tapes pertaining to the first audit period were provided to the auditor for review. The auditor's review of these tapes revealed that petitioner continued to use the same cash registers as were in use during the first audit period, and that such registers and the tapes they generated did not identify or describe the individual items being sold, but rather only indicated the dollar amount of the sale and whether

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<sup>3</sup> By a letter dated April 20, 2012, the Division advised that the audit period was expanded such that it would encompass, in total, the period December 1, 2007 through February 29, 2012. In the course of its audit, the Division obtained from petitioner a series of executed consents pursuant to which the period of limitations on assessment was extended to December 20, 2012.

the sales were rung into the register as taxable or nontaxable. The auditor further noted that there were two cash registers at petitioner's premises, but he was unable to discern if both were used since the tapes both refer to register "1" and clerk "1." The auditor further noted that there were some gaps where there were missing rolls of tapes, some instances where a register tape appeared to cover multiple days, and that there were many "no sale" listings on the tapes, indicating that the register drawer was opened and closed without any listed transaction on the tape. Petitioner attributed these latter "no sale" listings to instances where one or the other of the two cash registers was opened only for the purpose of obtaining change or small bills, as needed, between the two registers.

12. The auditor's review of the foregoing documents for the second audit period confirmed that petitioner did not maintain detailed records of its sales, including detailed cash register tapes or other source documents identifying individual sales or items sold, or the taxable versus nontaxable status of any of such individual items. Accordingly, the auditor concluded that the books and records were inadequate to conduct a complete audit so as to verify gross sales or the taxable status of any of petitioner's sales.

13. The Division's auditor utilized the results of the Division's August 7, 2008 observation of the deli's sales, and applied the same method of calculation as was used for the first audit period, to compute petitioner's tax liability for the second audit period (*see* findings of fact 6 and 7).<sup>4</sup> Specifically, by such method, the auditor computed audited taxable sales (\$3,023,509.31), reduced such amount by taxable sales reported per petitioner's sales and use tax returns (\$1,154,260.00), and thus arrived at additional taxable sales (\$1,869,249.31), with sales tax due thereon in the amount of \$161,222.74.

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<sup>4</sup> It is noted that the date of the observation (August 7, 2008) occurred during the second audit period herein.

14. On May 25, 2012, the Division issued to petitioner a notice of determination assessing additional sales and use tax due for the period December 1, 2007 through February 29, 2012 in the amount of \$161,122.74, plus interest and penalty.

***THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE***

The Administrative Law Judge found that the Division made clear and unequivocal requests for petitioner's books and records and that the records provided in response to such requests were insufficient for determining whether petitioner's sales were correctly reported, either as to total sales or taxable sales. The Administrative Law Judge thus concluded, that the Division was entitled to use an indirect method to determine petitioner's sales tax liability. The Administrative Law Judge observed that the use of a one-day observation test, as was employed in the present matter, has been determined by case law to be a reasonable indirect audit method. The Administrative Law Judge found that the use of such an audit method was well-suited to the circumstances herein and determined, accordingly, that the Division's use of a one-day observation audit in the present matter was reasonable. The Administrative Law Judge then noted that petitioner had the burden of proof to show that the result of the audit was unreasonably inaccurate or that the amount of tax assessed was erroneous. He found that petitioner failed to meet its burden.

The Administrative Law Judge also sustained the imposition of penalties against petitioner. He found that petitioner's record keeping failures, petitioner's conceded use of an estimate method in reporting its sales tax liability, and petitioner's concession of a significant sales tax deficiency supported the imposition of penalties.

***SUMMARY OF ARGUMENTS ON EXCEPTION***

Petitioner argues that the use of a one-day observation test was inappropriate because the volume of its business varies from day to day. Furthermore, petitioner asserts, its sales as determined by the Division's audit are greatly overstated and are incompatible with the operations of its "mom and pop delicatessen."

With respect to the noted deficiencies in its cash register tapes, petitioner's president contends that he has used the same type of cash register for more than thirty years and has never been told by a Division sales tax auditor that such a cash register was unacceptable. As to the condition of the tapes, petitioner asserts that the ink on some of the older cash register tapes was faded. Petitioner also contends that "no sale" was listed on some of the tapes because sometimes the cash register was opened just to get cash.

Petitioner contends that its underreporting of its sales tax liability was the result of an honest mistake, in that the 30% nontaxable sales estimate that petitioner's president and accountant used to calculate taxable sales was mistakenly deducted twice, once by petitioner's president and once by the accountant. As it did before the Administrative Law Judge, petitioner proposes a recalculation of its sales tax liability for the periods at issue by subtracting the 30% only once.

With its brief on exception, petitioner submitted four pages of documents that were not offered in evidence before the Administrative Law Judge. Such documents provide for a proposed recalculation of petitioner's sales tax liability in the amounts of \$25,395.53 for the first audit period and \$30,023.35 for the second audit period. We note that the amounts of such recalculation are similar to a proposed recalculation that is in the record.



Petitioner's president also contends that he provided all purchase invoices as requested and appears to challenge the auditor's conclusion that petitioner's purchase invoices were not in auditable condition. Petitioner's president also asserts that the deli sold beer only until 2008.

The Division contends that the Administrative Law Judge correctly determined that it properly used an indirect methodology in its audit of petitioner; that the method selected was reasonable; and that petitioner failed to prove any errors in the audit method or results.

The Division also urges this Tribunal to exclude from the record the documents submitted with petitioner's brief on exception.

### ***OPINION***

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] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ." The Division's right to use external indicies (sometimes referred to as an indirect method or an estimate) to determine tax pursuant to Tax Law § 1138 (a) (1) is predicated upon a taxpayer's failure to maintain or make available complete and adequate records (*see Matter of Chartair, Inc. v State Tax Commn.*, 65 AD2d 44, 46 [1978]; *Matter of AGDN, Inc.*, Tax Appeals Tribunal, February 6, 1997). Tax Law § 1135 (a) specifies that such records "shall include a true copy of each sales slip, invoice, receipt, statement or memorandum."

To determine the adequacy of a taxpayer's books and records, the Division must first make an explicit request for such books and records for the entire period of the assessment (*see Matter of Christ Cella, Inc. v State Tax Commn.*, (102 AD2d 352 [1984]; *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 books and records (*Matter of King Crab Rest. v Chu*, 134 AD2d 51

[1987]). If such review indicates that the records are so insufficient that it is virtually impossible 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 Division may resort to the use of external indices to estimate tax (*Matter of Chartair, Inc. v State Tax Commn.*).

As the Administrative Law Judge noted, the Division made several clear and unequivocal written requests for books and records of petitioner's sales (*see* findings of fact 3 and 9). The Division also met its obligation to thoroughly review such records (*see* findings of facts 4, 5, 10 - 12) and reasonably concluded that the records provided were insufficient to verify petitioner's gross and taxable sales for the audit period. On this last point, as the Administrative Law Judge also noted, "petitioner did not maintain or produce sales invoices or receipts, including cash register receipts, identifying in any manner the items sold in each transaction." Petitioner thus failed to meet its obligation under Tax Law § 1135 (a) to maintain "a true copy of each sales slip, invoice, receipt, statement or memorandum." Consequently, as the Administrative Law Judge found, "on audit the Division was unable to confirm that petitioner's reported nontaxable sales were, in fact, not subject to tax."

We thus agree with the Administrative Law Judge's conclusion that the Division established the inadequacy of petitioner's books and records and, accordingly, was entitled to use an indirect method to determine petitioner's sales and sales tax liability. It is well established that an audit method that estimates liability need not be exact, but must be "reasonably calculated to reflect the taxes due" (*Matter of W.T. Grant Co. v Joseph*, 2 NY2d 196, 206 [1957], *rearg denied* 2 NY2d 992 [1957], *cert denied* 355 US 869 [1957]; *see also Matter of Meyer v State Tax Commn.*, 61 AD2d 223 [1978], *lv denied* 44 NY2d 645 [1978]).

As the Administrative Law Judge correctly observed, the use of a one-day observation test as the basis of a sales tax assessment has been determined appropriate in several cases (*see e.g. Matter of Del's Mini Deli v Commissioner of Taxation & Fin.*, 205 AD2d 989 [1994]; *Matter of Lombard v Commissioner of Taxation & Fin.*, 197 AD2d 799 [1993]; *Matter of Sarantopoulos v Tax Appeals Trib.*, 186 AD2d 878 [1992]; *see also Matter of 88-02 Deli Grocery Corp.*, Tax Appeals Tribunal, September 13, 2012; *Matter of Marte*, Tax Appeals Tribunal, August 5, 2004).

Given petitioner's failure to maintain the required records of individual sales, as noted above, and given the ample precedent as cited above, we find, as did the Administrative Law Judge, that the Division's use of an observation test in the present matter was proper.

Where, as here, the Division appropriately uses an indirect audit method, petitioner bears the burden of proof to show that such audit method was unreasonably inaccurate or that the amount of tax assessed is erroneous (*see Matter of Meskouris Bros. v Chu*, 139 AD2d 813, 814 [1998]).

We agree with the Administrative Law Judge that the evidence produced by petitioner "falls far short of meeting this burden." We note, as did the Administrative Law Judge, that although petitioner objects to the use of a one-day observation test, it offered no evidence to show that the particular day on which the test was conducted was in any way unusual. We also agree with the Administrative Law Judge's observation that petitioner's complaints about the Division's audit method are "difficult to accept" considering that "petitioner itself utilized estimation as its method of reporting and filing."

Additionally, we find no support in the record for petitioner's contentions regarding its purchase invoices or its beer sales.

Regarding the documents submitted by petitioner with its brief on exception, this Tribunal has long and consistently held that we do not consider evidence offered with an exception if such evidence was not part of the record before the Administrative Law Judge (*see e.g. Matter of Katz*, Tax Appeals Tribunal, September 29, 2016). As we have often stated, our statutory obligation to provide a fair and efficient hearing process requires that such process be both defined and final and that the acceptance of evidence after the record has been closed is not conducive to this obligation (*see e.g. Matter of Laham*, Tax Appeals Tribunal, October 27, 2016). Accordingly, we do not accept the four pages of documents that were offered for the first time with petitioner's exception and we have not considered such documents in rendering this decision.

Petitioner did not raise the issue of penalties on exception. We therefore deem this issue abandoned (*see Matter of Crow and Sutton Assoc.*, Tax Appeals Tribunal, January 10, 2013).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Edelweiss Catering, Inc., is denied;
2. The determination of the Administrative Law Judge is affirmed;
3. The petitions of Edelweiss Catering, Inc., are denied; and

4. The notices of determination, dated March 2, 2009 and May 25, 2012, are sustained.

DATED: Albany, New York  
December 16, 2016

/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  
By JAM with permission