

STATE OF NEW YORK

DIVISION OF TAX APPEALS

---

In the Matter of the Petition :

of :

**LESLIE NILSSON** :

DETERMINATION  
DTA NO. 823622

for Revision of a Determination or for Refund of Sales and :  
Use Taxes under Articles 28 and 29 of the Tax Law for :  
the Period March 1, 2006 through May 31, 2007. :

---

Petitioner, Leslie Nilsson, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2006 through May 31, 2007.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 1384 Broadway, New York, New York, on June 11, 2013 at 11:00 A.M., with all briefs submitted by September 26, 2013, which date began the six-month period for the issuance of this determination. Petitioner appeared pro se. The Division of Taxation appeared by Amanda Hiller, Esq. (Michael B. Infantino, Esq., of counsel).

***ISSUES***

I. Whether the Division was warranted in resorting to an indirect audit methodology in this matter.

II. If the Division was correct in utilizing an indirect audit methodology, whether said methodology had a rational basis and was reasonably calculated to determine sales tax due for the audit period from Sage American Kitchen, Inc., and Leslie Nilsson, as officer.

III. Whether petitioner has demonstrated reasonable cause for the abatement of the penalty asserted.

***FINDINGS OF FACT***

1. During the period March 1, 2006 through May 31, 2007 (audit period), petitioner, Leslie Nilsson, was a person responsible for the collection and payment of sales and use taxes on behalf of Sage American Kitchen, Inc. (Kitchen), and has conceded her responsibility for same during the audit period.

2. Ms. Nilsson incorporated the business in 1997 and began business operations in 1998. The business operated the Café at St. Barts at St. Bartholomew's Episcopal Church, 109 East 50<sup>th</sup> Street, New York City. It also had two locations in Long Island City, New York, where it had its catering kitchen and a small "takeout shop" and restaurant.

3. The Division of Taxation (Division) began its audit of Kitchen on August 1, 2005 by mailing an appointment letter to the business in which it requested a meeting and the production of various documents by the taxpayer with regard to its sales and use tax liability for the period September 1, 2002 through May 31, 2005. The records requested included sales and use tax returns and federal income tax returns for the audit period; sales invoices, guest checks and cash register tapes; the general ledger; fixed asset and expense purchase records; the cash receipts and cash disbursement journals; bank statements and canceled checks and exemption documentation in support of tax-exempt sales. A second request for records was made on March 4, 2008, which extended the audit period and the request for records to May 31, 2007.

4. In response to the two requests for records, the Division received no source documentation for sales, i.e., sales invoices, guest checks or cash register tapes. In addition, in response to the second request, the Division received no bank statements, cash register tapes,

guest checks, sales invoices or fixed asset invoices. Other than the federal income tax returns, and sales tax returns, the only substantiation of sales of the business was the general ledger.

5. Shortly after the second request was made, and having received no further documentation, the Division determined that the records presented were insufficient and inadequate to perform a detailed audit.

6. When the auditor compared the sales reported in the general ledger to the sales reported on the sales tax returns for the period September 1, 2002 through May 31, 2007, it was noted that the sales per the general ledger were \$1,366,557.69 more than reported on the sales tax returns. The Division received no explanation for this discrepancy and attributed the excess amount to additional taxable sales.

7. The federal tax returns for 2003 and 2004 and bank statements for the period September 1, 2002 through May 31, 2005 were examined and indicated that there were more deposits than sales reported on the returns. However, since no bank statements were provided for any period after May 2005, the auditor calculated an error rate to estimate the differences for the extended period of the audit. The difference between the deposits and sales reported for the years 2003 and 2004 was \$870,285.77. The sales reported on the federal income tax returns for the same years was \$6,138,875.00. The resulting error ratio was calculated to be 14.18%.

When this error ratio was applied to the \$13,999,962.00 in sales reported on the federal returns for the years 2002 through 2007, it yielded additional taxable sales of \$1,984,723.21.

8. The Division added the additional taxable sales determined from the discrepancy between sales tax returns and the general ledger, \$1,366,557.69, and those calculated with the error ratio, \$1,984,723.21, to arrive at total additional taxable sales of \$3,351,280.90, and

additional sales tax due of \$283,722.80 for the full audit period, September 1, 2002 through May 31, 2007.

9. Using the depreciation schedules from the federal tax returns, the Division performed a detailed audit of the capital, or fixed asset, purchases for the audit period and found an additional \$107,738.00 in purchases on which tax was not paid that resulted in additional tax due of \$9,015.26.

10. Since a review of expense purchase records revealed that they were inadequate due to the condition of the records and the lack of internal controls, Division utilized a test period methodology to estimate the tax on expense purchases. Using the months of September, October and November 2004, the Division calculated additional expense purchases for the entire audit period of \$15,624.99 and additional tax due of \$1,323.77.

11. The total additional tax due on sales, capital purchases and expense purchases was \$294,061.83 for the full audit period September 1, 2002 through May 31, 2007. Of this amount, only the last five quarters was applied to petitioner because the period of limitations on assessment prohibited assessment prior to the quarter ended May 31, 2006.

12. The Division issued a Notice of Determination to petitioner, dated March 2, 2009, asserting additional sales and use taxes due in the sum of \$75,041.51, penalties of \$26,096.25 and interest of \$28,348.30, for a total amount due of \$129,486.06 for the audit period.

13. The penalties were imposed based upon petitioner's failure to pay its sales and use taxes when due and an underreporting of tax in excess of 25%. Petitioner magnified these failings by not providing adequate books and records for audit and having had an earlier audit that resulted in a significant amount of tax due.

14. There was commingling of records between Kitchen and another company controlled by petitioner, Sage American Catering, Inc. (Catering), which compounded the problems encountered when auditing Kitchen, and created confusion with regard to the operations of Kitchen in Long Island City. Petitioner was unable to resolve the confusion due to a lack of records.

15. Kitchen maintained a point of sale cash register system, but no records generated by the system were produced. Likewise, even though Kitchen maintained a QuickBooks accounting software system, only sparse summary sheets for the period prior to May 31, 2005 were made available for review on audit.

#### ***CONCLUSIONS OF LAW***

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every “retail sale” of tangible personal property except as otherwise provided in Article 28 of the Tax Law. A “retail sale” is “a sale of tangible personal property to any person for any purpose, other than . . . for resale as such . . .” (Tax Law § 1101[b][4][i]). 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 . . . .” (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

B. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.*, as follows:

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, [102 AD2d 352, 477 NYS2d 858] *supra*) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is "virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit" (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), "from which the exact amount of tax due can be determined" (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, "[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case" (*Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

C. The record demonstrates that the Division made two clear and unequivocal written requests for books and records and then thoroughly examined what was produced.

Unfortunately, those records fell woefully short of what would have been required to perform a full, detailed audit.

The two letters mailed to petitioner on August 1, 2005 and March 4, 2008 were accompanied by exhaustive lists of sales tax records requested for the period September 1, 2002 through May 31, 2007. In response, petitioner produced copies of federal income tax returns, sales tax returns, bank statements for the period prior to May 31, 2005, some invoices, partial accounts receivable schedules, some canceled checks and a general ledger but no source documentation, i.e., guest checks, receipts or cash register tapes. There were no bank records produced for the updated period. Although a point of sale register system was used, records from that system were not produced. Petitioner also used a QuickBooks software program to track sales and business operations, but that was lost in the transfer of files to a new computer after the audit period and records generated by that system were unavailable, with the exception of a few summary sheets applicable to the period September 1, 2002 through May 31, 2005.

Petitioner believed that bank statements for the extended audit period had been submitted after the Bureau of Conciliation and Mediation Services (BCMS) conference, but could not recall if it was the bank records of Kitchen or Catering. However, the confusion was resolved when the auditor credibly testified that she examined all documents submitted after the conference, but saw no new records or documents that changed the audit results.

Accuracy is not a requirement imposed on the Division when it is forced to rely on estimated audit methodologies due to a taxpayer's failure to produce adequate books and records (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023 [1976], *affd* 44 NY2d 684 [1978]). In this matter, the Division utilized only Kitchen's tax returns and business records to estimate the additional sales tax due, giving petitioner ample opportunity to verify or discredit the information. Unfortunately, petitioner did not produce clear and convincing evidence to show

that the audit methodology was not reasonably calculated to reflect taxes due or that the results of the audit methodology were erroneous.

Petitioner admitted that she did not have source documentation to support her recollection of sales and exempt sales and that she was aware there was commingling of bills, deposits and accounts between Kitchen and Catering. Thus, she has failed to submit clear and convincing proof that the returns filed were accurate and that the Division's estimate of sales and use taxes due for the audit period was erroneous. (*Matter of Blodnick v New York State Tax Commn.*, 124 AD2d 437 [1986]; *Matter of Surface Line Operators Fraternal Org. v. Tully.*) Having failed to meet her burden of proof, the Notice of Determination must be sustained.

D. Next, it must be determined if petitioner has established reasonable cause to abate the penalties imposed. Tax Law § 1145(a)(1)(i) provides for penalty to be imposed where a person fails to pay over any tax within the time required by law. Tax Law § 1145(a)(1)(vi) provides for an additional penalty when tax is understated by more than 25 percent. The Division assessed penalty under these sections. Tax Law § 1145(a)(1)(iii) and (vi) provide that the Division can remit the penalty if the failure to pay over the tax was due to reasonable cause.

In establishing reasonable cause for penalty abatement, the taxpayer faces an onerous task (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993). Referring to the mandatory language of Tax Law § 1145(a)(1)(i), the Tribunal said that "the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation." (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992.) In the instant matter, petitioner neither maintained nor produced records as required when requested on audit and the penalties asserted must be sustained.

Petitioner contended that a flood destroyed Kitchen's records and hindered her ability to prove the accuracy of her returns. However, she was unable to produce insurance documentation or fire department records to substantiate this claim, and therefore it must be rejected.

Although petitioner intimated that her reliance on her representative was the reason for the audit errors, it does not explain the failure to produce adequate books and records, which all taxpayers are required to maintain. In *Matter of AGDN, Inc.* (Tax Appeals Tribunal, February 6, 1997), the Tribunal stated that

a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135).

Petitioner testified that she knew there was an adversarial relationship between her accountant and the Division's auditor, but did not intercede or question why the audit progressed so slowly. The fact that she now believes she was not well served by her representative does not amount to reasonable reliance on a tax professional. In determining whether reasonable cause exists when a taxpayer relied upon the advice of a tax professional, it must be shown that the taxpayer relied in good faith on such advice and that it was reasonable for the taxpayer to rely on the advice (*see Matter of Auerbach v. State Tax Commn.*, 142 AD2d 390, 536 NYS2d 557, 561; (*Matter of LT & B Realty v. State Tax Commn.*, 141 AD2d 185, 535 NYS2d 121, 123). In *Matter of A & V Crown, Inc.*, Tax Appeals Tribunal, May 24, 1990, the Tribunal stated:

In order to demonstrate that petitioner's reliance was reasonable, it must be shown that the advice came from competent tax counsel (*see, Plante v. Commr.*, T.C. Memo 1985-117, 49 TCM 963, 966). The record here,

however, contains no evidence that the advice was furnished by a competent tax expert.

Since petitioner has not demonstrated that her reliance was reasonable, she has not justified an abatement of the penalties imposed.

E. The petition of Leslie Nilsson is denied and the Notice of Determination, dated March 2, 2009, is sustained.

DATED: Albany, New York  
March 13, 2014

/s/ Joseph W. Pinto, Jr.  
ADMINISTRATIVE LAW JUDGE