STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
BEIJING CHINA BUFFET, INC.	:	DETERMINATION DTA NO. 824804
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, 2007 through November 30, 2009.	:	

Petitioner, Beijing China Buffet, Inc., 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, 2007 through November 30, 2009.

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, 1384 Broadway, New York, New York, on October 1, 2013, at 10:30 A.M., with all briefs to be submitted by January 10, 2014, which date commenced the six-month period for issuance of this determination. Petitioner appeared by Stephen H. Marcus, Esq. The Division of Taxation appeared by Amanda Hiller, Esq. (Michele W. Milavec, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional sales and use taxes due from Beijing China Buffet, Inc., for the period March 1, 2007 through November 30, 2009 using an estimated audit methodology.

II. Whether the estimated audit methodology utilized by the Division of Taxation was rational and reasonably calculated to reflect the taxes due.

FINDINGS OF FACT

1. Petitioner, Beijing China Buffet, Inc. (Beijing), operated a Chinese buffet-style restaurant at 2429 Military Road, Niagara Falls, New York, between March 1, 2007 and November 30, 2009 (the audit period) making sales of food and drink.

2. An audit appointment letter, dated January 8, 2010, was mailed by the Division of Taxation (Division) to petitioner's owner, Mr. Ping Di Chen, to review petitioner's sales and use tax records for the period March 1, 2007 through November 30, 2009. The appointment was scheduled for February 2, 2010 and requested that specific records pertinent to the audit period be made available at that time, including: sales tax returns; federal income tax returns; New York State corporation tax returns; the general ledger; general journal and closing entries; all exemption documentation to support nontaxable sales; chart of accounts; fixed asset purchase and sales invoices for the audit period; expense purchases; merchandise purchases; bank statements, canceled checks and deposit slips for all bank accounts maintained by petitioner; cash receipts journal; cash disbursement journal; the corporate book; depreciation schedules for the audit period; State Liquor Authority license in effect for the audit period; utility bills; guest checks; and cash register tapes for the audit period.

3. On January 15, 2010, the auditor received a power of attorney from petitioner's new representative, Evelyn Kung, CPA, and rescheduled the audit appointment for May 17, 2010 at petitioner's representative's office to review petitioner's records.

4. On April 9, 2010, the auditor and two of her colleagues went to have lunch at petitioner's business location. The auditor noted that there was a sign at the register that indicated you must pay before eating. When the auditor and her colleagues arrived at the business location the cash register drawer was open with a man standing next to it. The auditor

ordered for three people, the man typed on a calculator that was off to the side of the cash register and stated that $21.00 was due. The man informed the auditor that drinks were included in the price given. The auditor then gave the man at the cash register $25.00, which he put in the drawer. He gave her back $4.00 in change, all the while leaving the cash drawer open.

5. Petitioner's representative advised the auditor that the auditor who handled the prior sales tax audit had original records of register tapes from the current audit period. The auditor obtained a box of register tapes that contained originals of the credit card receipts and batch statements for the period August through December 2007, daily z-tapes for the same months and five sheets of handwritten daily sales.

6. On May 17, 2010, the auditor traveled to Ms. Kung's office for the audit appointment to review petitioner's records, which included: a 2008 federal depreciation schedule; federal tax returns; bank statements; utility bills, a lease as of October 22, 2004; Merchants Bank statements for Heartland Payment Systems, Discover and American Express; cancelled checks; journal and general ledger for part of 2006 through October 2009, along with the z-tapes, purchase invoices and handwritten daily sales sheets previously obtained from the prior auditor.

7. On June 9, 2010, after a detailed review of all records provided, the auditor informed petitioner's representative that detailed sales records, such as cash register tapes and guest checks for the audit period March 1, 2007 through November 30, 2009 were not retained in full and could not be recreated for review. The auditor's letter of June 9, 2010 detailed the records that were requested from petitioner but not provided, or not provided in full, including summary z-tapes, bank statements from Merchants Bank, a federal tax return for 2009 and purchase invoices not related to food.

8. Given the lack of individual cash register tapes for each sale, lack of guest checks and lack of complete z-tapes and Merchants Bank records throughout the entire audit period, the Division found that there was inadequate source documentation for sales and it would be impossible to perform a detailed audit of petitioner's records to determine petitioner's tax liability for the audit period. Under these circumstances, the Division was forced to resort to an indirect audit methodology.

9. The Division initially rejected a mark-up test audit due to the fact that petitioner operated a buffet style restaurant, which prevented an accurate determination of the quantities of food sold. Instead, the Division decided to do a cash to credit card sale analysis, utilizing the results of a one-day observation test, which was conducted during the prior audit but the date of which fell during the current audit period at issue and coincided with petitioner's own records of credit card sales as disclosed in the banking records.

10. During the prior sales tax audit for the period September 1, 2004 through February 28, 2007, the Division's investigators conducted an observation at petitioner's restaurant on Thursday, November 8, 2007 from 10:30 A.M. to 8:00 P.M. The restaurant was located on a high traffic volume road close to the Niagara Prime Outlet Mall with seating for approximately 240 patrons. Customers paid for their meals upon entering regardless of whether they were eating in or taking the food out.

11. On November 8, 2007, between 11:00 A.M. and 8:00 P.M., there were 96 transactions, 16 of which were take-outs. The total value of all the transactions was $1,454.91, of which 14 were credit card transactions totaling $238.80, or 16.41% of the total. The amounts reported by the investigators from the observation were inclusive of sales tax. However, when the tax was backed out of the sales total, it amounted to $1,347.14. Credit card sales exclusive of

tax amounted to $221.11 and cash sales totaled $1,126.03. Based on these figures, the resulting cash to credit card sales ratio was 5.093, approximately 16.41%.

12. The total amount of cash sales could not be determined from petitioner's records, but because the credit card deposits were made directly into petitioner's bank account by the credit card companies, credit card sales could be tracked and substantiated by the Division. The Division accepted the credit card deposits to petitioner's bank account for the audit period per the bank statements provided to the Division but first made an adjustment for increased credit card usage over time per an article entitled *Nilsen: U.S. Payment Card Projections*, which indicated that the use of credit card transactions was up 7.7% from 2007. Thus, the Division allowed a 7.7% decrease in 2008, as well as compounding that for 2009, resulting in an audit adjustment favorable to petitioner. Then the Division marked up the credit card figures by 16.41%, the percentage of credit card sales to total sales as determined by the observation test, arriving at cash sales. The total audited taxable sales amount (including sales tax) was computed to be $3,711,730.42. After backing out the sales tax included in audited taxable sales, quarterly taxable sales were determined, and the appropriate tax rate was applied to each quarter to arrive at total audited tax due on sales of $274,942.99. Subtracting sales tax previously reported of $71,243.61, the Division determined additional tax on sales due per audit to be $203,699.39.

13. Based upon the audit findings, the Division issued to petitioner a Statement of Proposed Audit Change for Sales and Use Tax, dated August 3, 2010, setting forth additional sales tax due of $203,699.39, plus penalty and interest, for the period March 1, 2007 through November 30, 2009.

14. On November 15, 2010, as a result of the field audit performed, the Division issued to petitioner a Notice of Determination (assessment number L-035000023), asserting additional

sales tax due of $203,699.39, plus penalty and interest, for the period March 1, 2007 through November 30, 2009.

15. The Division submitted 14 proposed findings. In accordance with State Administrative Procedure Act § 307(1), the Division's proposed findings of fact have been generally accepted and made a part of the Findings of Fact herein.

SUMMARY OF THE PARTIES' POSITIONS

16. Petitioner argues that the methodology chosen by the Division was irrational and not reasonably calculated to reflect the sales tax due because the cash to credit card sales ratio applied a ratio established on one day that was not necessarily the same as all the others in the audit period. Petitioner maintains that the extrapolation of the single weekday cash to credit card sales ratio, obtained from the day of the observation, to the entire audit period results in average daily gross sales far in excess of the sales actually observed ($3,776.68 versus $1,454.91). Therefore, an accurate projection of sales could not be based on such a ratio.

17. Petitioner further contends that the Division has admitted that no comparison between its and petitioner's sales numbers was made and, in addition, that no effort was made to reconcile the differences existing between the Division's estimated gross sales and the comparable figures obtained from the observation audit. Accordingly, petitioner posits that in the absence of a basis for applying the cash to credit card ratio from a single day to the entire audit period, and the absence of any explanation reconciling the estimated cash and gross sales figures to the actual sales observed by the Division, the methodology employed by the Division is irrational and the Notice of Determination must be dismissed.

18. The Division argues that petitioner did not have adequate books and records available after properly requesting and then closely examining the records provided. It then

chose to perform an indirect audit using those books and records that were available and deemed accurate together with a previously performed observation test. Given the broad discretion the Division believes it has when faced with circumstances like those herein, it believes the cash to credit card sales ratio was both reasonable and accurate, although exactness was not required.

19. The Division further contends that petitioner's arguments were previously rejected by the Tax Appeals Tribunal in a case involving an earlier audit of petitioner (***Matter of Beijing China Buffet, Inc.***, February 23, 2012), and that a taxpayer, like petitioner, who fails to maintain sufficient books and records cannot substitute its own estimate of sales tax liability for the amount determined 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 § 1135(a)(1) provides that "[e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require." Such records include a "copy of each sales slip, invoice, receipt, statement or memorandum upon which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately." (***Id.***; 20 NYCRR 533.2[b][1].)

B. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed was 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).

C. 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).
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> 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. State Tax Commn.***, 119 AD2d 948, 501 NYS2d 219, 221).

D. In this case, the record establishes the Division's clear and unequivocal written request for books and records of petitioner's sales, as well as petitioner's failure to produce such books and records. The Division reasonably concluded that petitioner did not maintain or have available books and records that were sufficient to verify gross and taxable sales for the audit period, including any cash register tapes, guest checks or invoices. Having established the unavailability of required books and records, the Division was clearly entitled to resort to the use of indirect methods, including the use of an observation test, to determine petitioner's sales and sales tax liability. Indeed, the use of a one-day observation test has been specifically addressed and approved (***see Matter of Sarantopoulos v. Tax Appeals Tribunal***, 186 AD2d 878, 589 NYS2d 102 [1992]). Further, the law is clear that the results of a one-day observation test may reasonably be extrapolated over a multiple-year audit period ***(Matter of Marte***, Tax Appeals Tribunal, August 5, 2004).

E. It is noted that "[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. State Tax Commn.***, 119 AD2d 948, 950 [1986]). Whether the audit method used was "reasonably calculated to reflect the taxes due" (***Matter of W.T. Grant Co. v. Joseph***, at 206) can only be determined based on information made available to the auditor before the assessment is issued (***see e.g. Matter of Queens Discount Appliances***, Tax Appeals Tribunal, December 30, 1993; ***Matter of House of Audio of Lynbrook***, Tax Appeals Tribunal, January 2, 1992).

F. During the audit, petitioner provided the Division with bank statements for the audit period. These documents indicated deposits from major credit card vendors, which allowed the

auditor to compute the amount of credit card sales for the entire period. Petitioner's actual cash sales remained an unknown, which is critical since a significant portion of petitioner's business was cash sales. To determine cash sales, the Division monitored petitioner's sales during a one-day field audit and generated a cash-to-credit card sales ratio. The Division then estimated cash sales by applying this ratio to credit card sales, and assessed petitioner based on the total underreported amount.

As a general proposition, any imprecision in the results of an audit arising by reason of a taxpayer's own failure to keep and maintain records of all of its sales as required by Tax Law § 1135(a)(1) must be borne by that taxpayer (***Matter of Markowitz v. State Tax Commn.***; ***Matter of Meyer v. State Tax Commn.***). Petitioner specifically complains that the cash-to-credit card sales ratio resulted in a larger number of total sales than those actually generated by petitioner on the day of the observation. However, petitioner failed to adduce any source documentation, such as sales invoices, complete purchase invoices or cash register tape records, either on audit or at hearing, that would establish the actual amount of petitioner's sales throughout the audit period. Absent any records, petitioner's arguments do not provide any grounds for changing the Division's audit results. Therefore, it is concluded that petitioner has failed to carry its burden of showing the audit to be unreasonably inaccurate or clearly erroneous (***Matter of Beijing China Buffet, Inc.***).

G. As in the matter involving the previous audit, petitioner relies heavily on the rationale in ***Matter of Cjefa Pizza, Inc.*** (Division of Tax Appeals, January 8, 2009), which also utilized the cash-to-credit card sales ratio. Initially, it is noted that the Rules of Practice and Procedure of the New York State Tax Tribunal specifically provide that determinations of administrative law judges are not considered precedent and are not given any force or effect in other proceedings.

(20 NYCRR 3000.15[e][2].) Therefore, this determination will not base its conclusions on that case. However, it is also noted that the administrative law judge in ***Cjefa*** specifically concluded that the cash-to-credit card sales ratio was a reasonable audit methodology. Therefore, petitioner's reliance on the rationale in ***Cjefa***, notwithstanding its lack of precedential value, was misplaced since the judge's rationale supports the Division's methodology herein.

H. As was also done in petitioner's previous matter before the Tax Appeals Tribunal, petitioner asserts that ***Matter of 33 Virginia Place*** (Tax Appeals Tribunal, December 23, 2009) requires a cancellation of the notice of determination. In ***Matter of 33 Virginia Place***, the Division estimated the taxpayers' liability using an external index because the petitioners failed to maintain adequate books and records. However, in that case, at hearing, the auditor could not articulate a rational basis for the selected audit methodology. The taxpayers submitted expert testimony and evidence showing that the Division misapplied its selected audit methodology. As such, the Tax Appeals Tribunal cancelled the notices therein because the taxpayers met their burden of proof.

In response to petitioner's argument the Tax Appeals Tribunal, in the ***Matter of Beijing China, Inc.,*** stated that:

> [t[his matter is distinguishable from ***Matter of 33 Virginia Place***. Herein, the Division estimated petitioner's tax liability from petitioner's own records and from data gathered from an observation test at petitioner's place of business. At the hearing, the auditor repeatedly provided the rationale for choosing to apply the cash-to-credit card sales ratio to the estimated credit card sales. Moreover, petitioner introduced no persuasive evidence challenging the audit methodology or its rationale. As noted by the Administrative Law Judge, we find petitioner's arguments to be insufficient to meet its burden of proof. Accordingly, we conclude that petitioner failed to provide any grounds for either modifying or canceling the Notice of Determination issued to Beijing China Buffet, Inc.

For the reasons previously stated by the Tax Appeals Tribunal, petitioner's contention that the

Matter of 33 Virginia Place requires a cancellation of the Notice of Determination herein is rejected.

I. Petitioner argues that the cash-to-credit card sales ratio methodology was only one of several methodologies that could have been chosen, specifically referring to those which utilize indices from the Restaurant Industry Operations Report compiled by the National Restaurant Association and Deloitte & Touche LLP or a multi-day observation with adjustments for days of the week and seasons of the year. Petitioner's position is that these methods would have been more representative of its actual sales during the audit period.

In ***Matter of Burbacki*** (Tax Appeals Tribunal, February 9, 1995), the Tribunal stated:

> Such assertion does not meet petitioners' burden of proving by clear and convincing evidence that the result of the method used was unreasonably inaccurate (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679). At best, it is that a better picture of petitioners' liability may have been obtained had a different method been used. It is well established that where the taxpayer's failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required (***Matter of Club Marakesh v. Tax Commn.***, 151 AD2d 908, 542 NYS2d 881, ***lv denied*** 74 NY2d 616, 550 NYS2d 276).

The same rationale is applicable here. One could speculate that another method may have better projected petitioner's actual sales for the audit period, but that is not the requirement when petitioner has no sales records and operates a cash business, as was the case here. As noted above, the results of a one-day observation test may reasonably be extrapolated over a multiple-year audit period (***Matter of Marte***), and the Tax Appeals Tribunal has held that the cash to credit card sales ratio, specifically with regard to petitioner, is a reasonable audit methodology (***Matter of Beijing China Buffet, Inc.***).

J. In establishing reasonable cause for the abatement of penalty, the taxpayer faces an onerous task (***Matter of Philip Morris, Inc.***, Tax Appeals Tribunal, April 29, 1993). In ***Philip***

Morris it was explained that "[b]y first requiring the imposition of penalties (rather than merely allowing them at the Commissioner's discretion), the Legislature evidenced its intent that filing returns and paying the tax according to a particular timetable be treated as a largely unavoidable obligation [citation omitted]" (***Matter of MCI Telecommunications Corp.***, Tax Appeals Tribunal, January 16, 1992, ***confirmed*** 193 AD2d 978, 598 NYS2d 360 [1993]). Here, petitioner failed to make adequate books and records available for audit and substantially underreported and underpaid the tax due. Under these circumstances, the waiver of penalties is not justified.

K. The petition of Beijing China Buffet, Inc. is denied, and the Notice of Determination dated November 15, 2010 is sustained, together with such penalties and interest as may be lawfully due.

DATED: Albany, New York
May 1, 2014

/s/ Thomas C. Sacca
ADMINISTRATIVE LAW JUDGE