

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions	:	
of	:	
CASA DI PIZZA, INC.	:	
AND	:	DETERMINATION
JOSEPH JACOBBI	:	DTA NOS. 825196,
for Revision of Determinations or for Refund of	:	826120, 826121,
Sales and Use Taxes under Articles 28 and 29 of	:	826123 AND 826124
the Tax Law for the Period March 1, 2004 through	:	
February 28, 2011.	:	
	:	

Petitioners, Casa Di Pizza, Inc., and Joseph Jacobbi, filed petitions 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, 2004 through February 28, 2011.

A hearing was commenced before Donna M. Gardiner, Administrative Law Judge, on May 6, 2015, and continued to conclusion on May 7, 2015, in Rochester, New York. Petitioners appeared by Amigone, Sanchez & Mattrey, LLP (Bill P. Oliverio, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Osborne K. Jack, Esq., of counsel) with all briefs to be submitted by October 2, 2015, which date began the six-month period for issuance of this determination. By letter dated March 28, 2016, the Administrative Law Judge extended the time for issuance of this determination for three months pursuant to Tax Law § 2010(3).

ISSUES

I. Whether petitioner has demonstrated that the Division of Taxation’s audit methodology was unreasonable.

II. Whether penalties imposed should be abated for reasonable cause and an absence of wilful neglect.

III. Whether the Division of Taxation has sustained its burden of proof to show that the imposition of fraud penalty pursuant to Tax Law § 1145(a)(2) was proper.

FINDINGS OF FACT

1. Petitioner Casa Di Pizza, Inc., operates a restaurant at 477 Elmwood Avenue in Buffalo, New York. The business is a full service restaurant and bar with a deli. In addition, it has a large take out and delivery business and provides catering and banquet facilities. Petitioner provides delivery services as far as the Rochester area, which is estimated to be approximately one hour away.

2. Petitioner Joseph Jacobbi operates the restaurant, which has been a family business since 1953. His status as a responsible person for the business is not in dispute.

3. In July of 2008, the Division of Taxation (Division) commenced a sales tax field audit of petitioners. On July 11, 2008, the Division sent an appointment letter to Mr. Jacobbi and requested the restaurant's books and records for the audit period. The records requested by the Division included sales tax returns, federal income tax returns, corporation tax returns, general ledger, sales invoices, exemption documents, bank statements, cash receipts journal and cash disbursement journal.

4. On August 5, 2008, the Division's auditor and her supervisor met with Mr. Jacobbi and his representative. Mr. Jacobbi indicated that the business did not maintain any records of guest checks, cash register tapes or summary reports. Mr. Jacobbi claimed that the restaurant transcribed sales information from its cash registers onto weekly Excel reports. Weekly Excel

reports for the period June 2005 through December 2006 were provided. He also provided a box of records that he claimed represented sales that were tax exempt.

5. The auditor reviewed the documents presented and found that the records were insufficient to substantiate the claimed exempt sales. The auditor noted that some guest checks contained a hand-written notation that the sales were to the Children's Hospital of Buffalo, but there was no other evidence that the hospital actually ordered or paid for the food.

6. The auditor was unable to reconcile purchase information provided with the purchases reflected in the restaurant's general ledger. The auditor also was unable to reconcile sales listed according to the restaurant's books and records to sales reported on its sales tax returns.

Moreover, in reviewing petitioners' federal income tax returns, the sales reported therein could not be reconciled with the sales reported on their sales tax returns.

7. The auditor then tried to reconcile bank deposits to sales reported on the sales tax returns and discovered that bank deposits far exceeded reported sales. In fact, although the bank information provided contained only credit card sales, and no cash sales, the bank deposit amounts still were larger than the reported sales on the sales tax returns. As a result of the huge discrepancy, the audit was referred to the Division's Revenue Crimes Unit to be pursued as a criminal investigation.

8. The criminal investigation was performed by a separate auditor from the Revenue Crimes Unit. The auditor subpoenaed the restaurant's bank records and received information about its bank deposits for the period March 1, 2004 through May 31, 2008. After reviewing this information, the auditor determined that there was little to no cash being deposited into the bank, there were only a few checks deposited and the majority of deposits were from credit card sales.

9. The auditor was told by petitioners' representative that checks deposited into the accounts of the business consisted of sales to exempt organizations and banquet hall sales. The auditor subpoenaed information from the exempt organizations and verified that their purchases from the restaurant were paid by check, which resulted in her including only credit card sales in her investigation to determine whether the proper amount of sales tax was reported by petitioners.

10. From the amounts of the credit card sales, the auditor deducted 15%, which represented service charges or gratuities and sales tax. The auditor compared net credit card receipts to reported sales and determined that credit card receipts exceeded taxable sales reported by \$1,202,551.01. This resulted in additional tax due, from credit card sales alone, of \$104,295.31.

11. The Division's Revenue Crimes Unit then referred the case to the Erie County District Attorney's Office for criminal prosecution based upon the collection of, and failure to remit, sales tax in the amount of \$104,295.31. On August 19, 2010, as part of a plea deal, Mr. Jacobbi waived indictment and consented to be prosecuted by a Superior Court information charging him with a lesser charge of grand larceny in the third degree. On October 18, 2010, Joseph Jacobbi signed a Confession of Judgment pleading guilty to the collection of sales tax, but failure to remit such collected money, to the Division on behalf of his business for the period March 1, 2004 through May 31, 2008. As part of his plea agreement, Mr. Jacobbi was ordered to pay restitution.

12. Following the guilty plea, the criminal investigation was closed and the audit was returned to the Division's Civil Audit Department. The Division issued Notice of Determination No. L-036716062, dated October 13, 2011, to Casa Di Pizza, Inc., assessing fraud penalties and interest in connection with the criminal investigation that resulted in Mr. Jacobbi pleading guilty

to stealing \$104,295.31 in sales tax that he collected but had not remitted to the Division.

13. On June 23, 2011, the auditor sent a letter to petitioners requesting books and records for an expanded civil audit period of March 1, 2004 through May 31, 2008. By letter dated June 27, 2011, the auditor requested that petitioners' representative (at that time) present the records in auditable condition.

14. On August 10, 2011, the Division received correspondence from David Gross who was appointed to represent petitioners on the audit. Mr. Gross provided the auditors with guest checks for the month of November 2010.

15. The auditors transcribed the guest checks and determined that there were large gaps in the sequence of numbers indicating that there were missing guest checks. It was also discovered that numerous guest checks had the same sequence numbers. Moreover, the guest checks did not reconcile to the restaurant's system balance reports.

16. In response to further requests for books and records, Mr. Gross provided guest checks for the month of November 2008. A review of these guest checks revealed far fewer numbers of guest checks for that month and these checks did not reconcile to the restaurant's system balance reports.

17. In order to further test the adequacy of the records provided, the Division requested that petitioners' representative provide copies of the restaurant's guest checks for the fifth day of each month. This request was denied by the representative.

18. Based upon the inability to verify the records, the Division determined that there were insufficient records to determine whether petitioners had reported the proper amount of tax due for the periods in issue.

19. On November 2, 2012, the auditor informed petitioners that, because the records presented were inadequate to perform a detailed audit, the Division would conduct an observation test to estimate petitioners' sales tax liability for the periods in issue.

20. The Division conducted an all-day observation of the restaurant on November 7, 2012. At the beginning of the observation, the auditors requested that Mr. Jacobbi print a copy of each guest check for each sale of the observation day. Petitioners told the auditors that the bar area was the only place where duplicate guest checks would be able to be printed and no ability to produce a duplicate was available for all other areas of the restaurant.

21. The Division had multiple people conducting the observation of the restaurant. Everyone was instructed to record the time, amount and method of payment for each sale as well as the items sold. At the conclusion of the observation, the auditors reconciled their results to the guest checks provided by petitioners reflecting the day's sales.

22. Total gross receipts for the observation day were \$7,431.52. The auditors deducted exempt sales recorded on the day of \$55.23 as well as sales tax in the amount of \$598.86 to arrive at taxable sales for the observation day of \$6,777.43. The Division then divided the credit card sales for the day in the amount of \$4,004.99 by the taxable sales in the amount of \$6,777.43, which resulted in a taxable sales-to-credit percentage of 59.09.

23. The Division then used this 59.09% of credit card sales to determine additional tax due for the audit period. Through information subpoenaed from petitioners' bank records, the Division verified that for the period March 1, 2004 through May 31, 2008, petitioners had credit card deposits of \$6,326,692.91. This amount was divided by 59.09% to determine audited taxable sales of \$10,706,875.80 and a resulting sales tax due of \$883,317.25.

24. The Division took the amount of sales tax due and gave petitioners credit for: (1) the tax paid with the sales tax return, in the amount of \$319,906.35, and (2) the amount of \$104,295.31 paid in restitution in connection with the criminal investigation, which resulted in additional sales tax due of \$459,115.61 plus penalties and interest.

The Division issued Notice of Determination No. L-039095367 dated February 27, 2013 to Casa Di Pizza, Inc., assessing tax due in the amount of \$459,115.61 plus penalties and interest for the period March 1, 2004 through May 31, 2008.

25. The auditors also conducted an analysis of petitioners' credit card deposits for the period June 1, 2008 through February 28, 2011. The credit card deposits for this period were \$4,535,202.80. Using the same credit card ratio used in the prior audit period, the auditors divided these credit card receipts by 59.09% to determine audited taxable sales of \$7,675,076.66, which resulted in audited sales tax due of \$671,569.21. The auditors then subtracted sales tax paid of \$396,696.57, which resulted in a balance of additional sales tax due of \$314,872.64 for this audit period.

The Division issued Notice of Determination No. L-039095332 to Casa Di Pizza, Inc., assessing \$314,872.64 in additional sales tax due for the period June 1, 2008 through February 28, 2011.

26. The Division also issued separate notices of determination to Joseph Jacobbi as a responsible person for the taxes of the restaurant. Notice of Determination No. L-039125878, dated March 12, 2013, assessed \$459,115.61 in additional sales tax, penalties and interest for the period March 1, 2004 through May 31, 2008 and Notice of Determination No. L-039125924, dated March 12, 2013, assessed \$314,872.64 in tax, plus penalties and interest for the period June

1, 2008 through February 28, 2011.

27. At the hearing in this matter, the Division presented three auditors who were involved with both the civil and criminal audits conducted of petitioners. The testimony explained the performance of the audit, the determinations made and the basis for these determinations. The auditors described the request for books and records and which documents were not provided from the requested list. The auditors testified to the inadequacies and unexplained discrepancies in the records that were produced including the lack of reliable and verifiable sales documents from which a detailed audit could be performed.

28. Because petitioners produced inadequate books and records from which a detailed audit could be performed, the auditors testified that the Division chose to conduct an observation test as an estimate audit methodology to accurately estimate petitioners' additional sales tax liability.

29. Petitioners presented four witnesses at the hearing, in addition to presenting a Division employee, in the presentation of their case. Petitioner Joseph Jacobbi testified to his involvement with the restaurant. He stated that he was involved in all aspects of operating the restaurant. Mr. Jacobbi was a responsible person on behalf of the restaurant.

30. Mr. Jacobbi explained that the restaurant has been a family business since around 1953. The restaurant was originally started by his father and has been in the same location since its inception. Mr. Jacobbi stated that he has been employed by the restaurant since he was 19 years old, and has been running the entire operation for approximately 40 years. He described the restaurant as having a dining room for patrons, a takeout and delivery service, a bar and banquet facilities. Mr. Jacobbi described the menu as one of a typical Italian restaurant. He explained that

the takeout and delivery portion involves primarily pizza, subs and chicken wings.

31. Mr. Jacobbi testified with respect to the layout of the restaurant. There were 13 pictures portraying certain rooms of the restaurant submitted into evidence. The pictures did not show the entire facility. Specifically, he testified that there were two dining rooms, but only one was pictured. Moreover, there were no pictures of the banquet facilities.

32. Mr. Jacobbi testified to the hours of operation as well as his pricing policies. He testified regarding the number of employees and their shifts. However, he was not referring to any documentation with respect to this information, nor was any evidence presented regarding the pricing policies of the restaurant. Mr. Jacobbi's testimony was often given as a result of leading questions, which undermine both the credibility and reliability of the information gleaned.

33. Mr. Jacobbi testified that a certain percentage of his sales were tax exempt. He made sales to Buffalo City schools for children's lunches. However, the documentation provided on audit for the months of November 2008 and November 2010 indicated that a majority of the restaurant's exempt sales consisted of pickups by and/or deliveries to medical staff, nursing staff, patients and visitors of the Women's and Children's Hospital of Buffalo, which is located around the corner from the restaurant. There were no hospital purchase orders or exempt organization certificates associates with any order reviewed. Orders were paid by personal credit cards or cash. These sales were not to the hospital itself.

34. Mr. Jacobbi testified that there were no banquets held during the audit periods, other than an occasional use of the room by a local church. The restaurant has a banquet room on the upper level of its facility. As noted, there were no pictures of this level of the facility. The banquet room has banquet tables, banquet chairs, a full-service bar, a dance floor and restrooms.

Petitioners had a printed banquet menu and banquets were advertised on petitioners' website. Additionally, copies of banquet contracts were supplied by petitioners' former representative and the Public Employees Federation held their annual holiday banquet at the restaurant for several consecutive years, including years within the audit period.

35. Despite evidence that all exempt sales did not qualify as such and in contravention to petitioners' assertion that the restaurant did not have much of a banquet business as stated in the above findings of fact, the auditors elected not to audit both the exempt sales and banquet issues in order to be as fair and reasonable as possible with petitioners.

36. Mr. Jacobbi tried to minimize his guilty plea, as a result of the criminal investigation by the Erie County District Attorney's office. In fact, he attempted to distance himself from his crime by downplaying its significance by explaining that he pled to a grand larceny charge which he understood to be stealing more than \$3,000.00. As the facts demonstrate, he admitted to stealing sales tax money and paid restitution in excess of \$100,000.00.

37. Petitioners also presented the testimony of James Jacobbi, who is the brother of Joseph Jacobbi. James Jacobbi testified that he resided in Florida, but decided by the end of 2008 to travel back and forth to Buffalo in order to assist his brother with the business. He testified that his goal was to get the finances to be more profitable and also to clean up the accounting for the business.

James Jacobbi testified to general numbers generated by the business and he gave estimates regarding numbers of employees, numbers of patrons on particular nights and estimates of what sales constitute a good night at the restaurant. His testimony merely mirrored that of Joseph Jacobbi. All his assertions were clearly estimates and had no basis in any documents.

Moreover, he failed to describe whether he took any action regarding improving the maintenance of books and records for the business.

38. Petitioners also presented David Gross, who represented them during the audit periods. Mr. Gross did not dispute the fact that petitioners' books and records were inadequate. Rather, he discussed certain exhibits created by him. These exhibits were created using documents that were unverifiable. Mr. Gross put forth his estimates as a more reasonable calculation of additional sales tax due. It is noted that within his analysis, he considered sales of frozen dinners that were being produced and sold. It is important to note that petitioners failed to demonstrate the extent of any frozen food business.

39. With respect to the processing and sale of frozen dinners, there was no specific time frame of this operation. Moreover, in the pictures submitted into evidence, there was no photograph depicting the frozen food processing operation or even the machine used to seal the products for sale. There is a copy of a picture of Joseph Jacobbi standing next to a freezer of what appear to be frozen foods, but there is no indication of when the picture was taken. Significantly, there was no documentation provided that indicated any quantity sold or pricing of these meals. Petitioners allege that they were no longer in the business of selling frozen meals but could not prove when such operation ceased. Therefore, any analysis based upon a frozen food business is patently erroneous.

CONCLUSIONS OF LAW

A. Tax Law § 1105(a) imposes a sales tax on the receipts from every retail sale of tangible personal property. Tax Law § 1135(a)(1) requires that a taxpayer maintain and make available for audit, upon request, such records as are sufficient to verify all transactions, and any failure to

maintain such records or the maintenance of inadequate records will result in the Division estimating the tax due (Tax Law § 1138[a][1]; 20 NYCRR 533.2). When acting pursuant to Tax Law § 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due. The burden of proof then shifts to the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see Matter of Your Own Choice*, Tax Appeals Tribunal, February 20, 2003).

Petitioners did not maintain adequate books and records from which a detailed audit could be performed. The sales records did not allow the opportunity to trace any transaction back to the original source or forward to a final total. Additionally, the reported sales on petitioners' federal income tax returns could not be reconciled with the sales reported on petitioners' sales tax returns. Therefore, the Division was authorized to estimate sales tax using an external index chosen to properly estimate tax due.

B. In order to estimate petitioners' tax liability, the Division was required to select an audit method that was reasonable (*Matter of W. T. Grant Co. v. Joseph*, 2 NY2d 196 [1957], *cert denied* 355 US 869 [1957]; *Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948 [1986]). Exactness is not required when it is petitioner's failure to maintain proper records which prevents it (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223 [1978], *lv denied* 44 NY2d 645 [1978]; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023 [1976], *affd* 44 NY2d 684 [1978]; *Matter of Lionel Leasing Indus. v. New York State Tax Commn.*, 105 AD2d 581 [1984]).

The burden of proof falls upon petitioner to demonstrate by clear and convincing evidence that the audit method employed was unreasonable or that the amount assessed was erroneous

(*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813 [1988]; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858 [1981]).

Petitioners fell woefully short of demonstrating any error with the audit findings. Petitioners assert many baseless allegations in support of their position. However, the bulk of their evidence relies on the testimony of Joseph Jacobbi. His testimony was vague and nonspecific, was leading in nature and lacked credibility given the absence of contemporaneous documentation to support many of his assertions.

It is quite clear from the record that the Division reviewed the records presented by petitioners and correctly concluded that they were not adequate to do a complete audit (*see Matter of Vebol Edibles v. State of New York Tax Appeals Trib.*, 162 AD2d 765 [1990], *lv denied* 77 NY2d 803 [1991]; *Matter of Club Marakesh v. Tax Commn. of State of New York*, 151 AD2d 908 [1989], *lv denied* 74 NY2d 616 [1989]). The auditors articulated what documents they looked at and how their computations were derived. The Division performed a one-day observation test. The observation results were used to establish a ratio of credit card to cash sales. In order to refute any error in the Division's calculations, petitioners were required to demonstrate that the Division made errors in its calculations or with the methodology utilized. However, petitioners did not submit any probative evidence demonstrating that any errors were made by the Division.

C. Petitioners argue that penalties imposed pursuant to Tax Law § 1145(a)(1)(vi), based upon the omission from the total amount of sales tax required to be shown on its returns in excess of 25%, should be abated. This argument is rejected. Petitioners have not shown that the failure to pay the taxes was due to reasonable cause and not wilful neglect. Petitioners merely state that

since the audit is unreasonable, no penalties are due.

D. Petitioners allege that the Division's Buffalo District Office has a history of flawed criminal charges, such as the charges contained in this case. Petitioners further state, in part, that: "Joseph Jacobbi's criminal plea should be disregarded when weighing the evidence presented by [p]etitioners at the hearing" (Petitioners' brief in support, p. 25). This argument is rejected.

The burden of proving fraud rests with the Division (*Matter of Aqua-Mania, Inc.*, Tax Appeals Tribunal, March 6, 2008; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). A finding of fraud requires the Division to show by "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representation, resulting in deliberate nonpayment or underpayment of taxes due and owing" (*Matter of Sona Appliances*, Tax Appeals Tribunal, March 16, 2000). Fraud need not be established by direct evidence, but can be shown by surveying the taxpayer's entire course of conduct and drawing reasonable inferences therefrom (*Matter of Cousins Serv. Sta.*, Tax Appeals Tribunal, August 11, 1988).

As set forth in Finding of Fact 11, on August 19, 2010, as part of a plea deal, Mr. Jacobbi waived indictment and consented to be prosecuted by a Superior Court information charging him with a lesser charge of grand larceny in the third degree. On October 18, 2010, Joseph Jacobbi signed a Confession of Judgment pleading guilty to the collection of sales tax, but failure to remit such collected money to the Division on behalf of his business for the period March 1, 2004 through May 31, 2008. As part of his plea agreement, Mr. Jacobbi was ordered to pay restitution. This statement is an admission that petitioner committed acts constituting tax fraud over the entirety of March 1, 2004 through May 31, 2008. Therefore, the imposition of fraud penalty

herein is sustained.

E. The petitions of Casa Di Pizza, Inc. and Joseph Jacobbi are denied, and the notices of determination are sustained.

Dated: Albany, New York
June 23, 2016

/s/ Donna M. Gardiner
ADMINISTRATIVE LAW JUDGE