

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
JIGAR CORPORATION : DETERMINATION
 : DTA NO. 820593
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 June 1, 2000 through February 28, 2003. :

Petitioner, Jigar Corporation, c/o Mike's Deli & Getty Gas, 570 Sunrise Highway, West Islip, New York 11795, 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 June 1, 2000 through February 28, 2003.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on February 23, 2006 at 10:30 A.M., with all briefs to be submitted by May 30, 2006, which date began the six-month period for the issuance of this determination. Petitioner appeared by Peter J. Zahakos, Esq. The Division of Taxation appeared by Mark F. Volk, Esq. (Jennifer A. Murphy, Esq., of counsel).

ISSUES

- I. Whether the Division of Taxation properly determined additional sales and use taxes due from petitioner.
- II. Whether penalties assessed against petitioner should be abated.

FINDINGS OF FACT

1. During the period at issue herein, petitioner operated a deli/convenience store known as Mike's Deli and Getty Gas Station at 570 Sunrise Highway, West Islip, New York. Petitioner sold taxable items such as sandwiches, hot dogs, breakfast specials, candy, soda, beer and cigarettes and also sold some nontaxable items such as bread, milk and newspapers.

2. An audit of petitioner's business was commenced by the Division of Taxation ("Division") in May 2003. By letter dated May 19, 2003, petitioner was advised of the audit and was directed to provide to the Division all books and records pertaining to its sales and use tax liability for the audit period, i.e., June 1, 2000 through February 28, 2003. Records requested by the Division pursuant to the letter included sales tax returns, worksheets and canceled checks, Federal income tax returns, New York State corporation tax returns, a general ledger, a general journal and closing entries, sales invoices, exemption documents, fixed asset purchase and sales invoices, expense purchase invoices, merchandise purchase invoices, bank statements with canceled checks and deposit slips for all bank accounts, cash receipts journal, cash disbursement journal and depreciation schedules.

3. In response to the Division's request for books and records, petitioner produced some canceled checks for goods purchased and various checks for a 22-month period (although not 22 consecutive months) during the audit period. Many months of checks were missing and no sales records or cash disbursement journal was provided by petitioner.

As a result of petitioner's failure to produce the records requested, the auditor deemed petitioner's records insufficient to perform a detailed audit and, therefore, decided to conduct an observation test to determine its taxable sales. The primary reason for selecting an observation

test to determine taxable sales was because the auditor was unable to ascertain all of petitioner's suppliers. No audit of petitioner's expense purchases was performed.

4. The observation test was conducted at petitioner's place of business on Tuesday, January 6, 2004, beginning at approximately 5:00 A.M. Although petitioner was open for business 24 hours a day, the observation test was conducted for 19 hours, i.e., from 5:00 A.M. until midnight. Three investigators employed by the Division took shifts whereby they stood near the cash register and recorded all sales which were rung up by petitioner's employees. During the observation test, the investigators found that some items were not being rung up properly on the cash register. Some taxable items were being rung up as nontaxable and some items were being manually rung up at prices lower than scanned prices per the items' bar code. On some occasions, when paying at the cash register, customers would indicate that they thought the prices were higher than what they were being charged by the store clerk. When the owner arrived at the business premises and spoke to one of the investigators, he claimed that he was not aware of what items were taxable and what items were nontaxable.

5. During the hours of observation of petitioner's business (5:00 A.M. until midnight), the investigators recorded \$2,187.40 in total sales. By using the cash register tape for the 24-hour period from the beginning of the observation test and by accepting the accuracy of the tape, the auditor was able to determine the sales for the period when no observation test was performed, i.e., midnight until 5:00 A.M. on Wednesday, January 7, 2004. Total sales per the register tape were \$2,375.53. By subtracting observed sales of \$2,187.40 from the total sales of \$2,375.53, it was determined that sales for the period from midnight until 5:00 A.M. were in the amount of \$188.13.

To determine the taxable ratio for sales during the period observed, the auditor subtracted from total observed sales of \$2,187.40 the amount of \$225.59 which was the total amount of nontaxable sales observed, thereby resulting in taxable receipts of \$1,961.81. To calculate taxable sales, the auditor divided the taxable receipts of \$1,971.81 by 1.0875 (the applicable tax rate was 8.75%) to arrive at taxable sales of \$1,803.96. Sales tax collected on taxable sales ($\$1,803.96 \times .0875$) was \$157.85. By subtracting sales tax collected from total sales observed ($\$2,187.40 - \157.85), gross sales were determined to be \$2,029.55. By dividing taxable sales by gross sales for the period observed ($\$1,803.96 \div \$2,029.55$), the auditor found the taxable ratio to be 88.88%. On its sales tax returns filed for the periods at issue, petitioner's reported taxable ratio ranged from 28.26% to 40.23%.

6. By applying the taxable ratio of 88.88% to the sales for the period when no observation test was performed (\$188.13), the auditor found taxable receipts to be \$167.22. Dividing the taxable receipts (\$167.22) by the applicable tax rate (1.0875) resulted in taxable sales for the period midnight to 5:00 A.M. of \$153.77.

Accordingly, total taxable sales for the 24-hour period from 5:00 A.M. on January 6, 2004 until 5:00 A.M. on January 7, 2004 were \$1,957.73 ($\$1,803.96 + \153.77). By multiplying this daily total by 91 days (the total number of days in the sales tax quarter), quarterly taxable sales were determined to be \$178,153.43. The quarterly figure was then multiplied by the 11 sales tax quarters in the audit period to yield total taxable sales for the audit period in the amount of \$1,959,687.73. Tax due, at 8.25% for the period June 1, 2000 through May 31, 2001 and at 8.75% for the period June 1, 2001 through February 28, 2003, was \$164,791.92. Petitioner was then given credit for sales tax reported for the audit period (\$15,003.00), cigarette credit/prepayment (\$29,506.00) and collection credit allowed for acting as the trustee for the

State's tax money (\$672.00), which resulted in additional tax due for the audit period in the amount of \$119,610.92.

7. As a result of the foregoing, the Division, on February 17, 2004, issued a Notice of Determination to petitioner which assessed additional sales and use taxes due of \$119,610.92, plus penalties and interest, for a total amount due of \$203,835.85, for the period June 1, 2000 through February 28, 2003.

A statutory penalty (Tax Law § 1145[a][1][I]) and an omnibus penalty for omission of an amount in excess of 25% of the amount of taxes required to be shown on the return (Tax Law § 1145[a][1][vi]) were imposed by the auditor. The omnibus penalty was imposed since the auditor determined that petitioner was underreporting taxable sales by approximately 250%.

SUMMARY OF PETITIONER'S POSITION

8. Petitioner did not appear at the hearing. The contentions of his representative were that a one-day observation test was not representative of petitioner's sales during the audit period and that the auditor's calculation of an 88.88% taxable ratio was excessive. However, no additional books and records were presented to substantiate these contentions.

CONCLUSIONS OF LAW

A. 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 shall include a true 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.

The sales records required to be maintained include, among other things, sales slips, invoices, receipts, statements or other memoranda of sale, guest checks, cash register tapes and any other original sales documents (20 NYCRR 533.2[b][1]). When no written document is given to the customer, the seller is required to keep a daily record of all cash and credit sales in a day book or similar book (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 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).

C. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.* (Tax Appeals Tribunal, February 20, 2003), 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).

D. The courts have upheld the use of observation tests on numerous occasions (*see, Matter of Del’s Mini Deli v. Commr. of Taxation and Finance*, 205 AD2d 989, 613 NYS2d 967; *Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878, 522 NYS2d 102; *Matter of Vebol Edibles v. Tax Appeals Tribunal*, 162 AD2d 765, 577 NYS2d 678, *lv denied* 77 NY2d 803, 567 NYS2d 643; *Matter of Club Marakesh v. State Tax Commn.*, 151 AD2d 908, 542 NYS2d 881, *lv denied* 74 NY2d 616, 550 NYS2d 276; and *Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679). Furthermore, it is reasonable to extrapolate the results of a one-day test over a multi-year audit period. (*See, Matter of Del’s Mini Deli v. Commissioner of Taxation and Finance, supra; Matter of Lombard v. Commr. of Taxation and Finance*, 197 AD2d 799, 602 NYS2d 972; *Matter of Marte*, Tax Appeals Tribunal, August 5, 2004; *Matter of Himed Deli Corp.*, Tax Appeals Tribunal, March 30, 2000.)

E. In the present matter, the record shows that the Division made a written request for petitioner's books and records. In response to the request, petitioner supplied some checks for part of the audit period. Clearly, these checks were insufficient to verify taxable sales receipts and to perform a detailed audit. Therefore, the Division properly resorted to external indices to estimate tax due.

It is petitioner's burden to prove, by clear and convincing evidence, that the audit method utilized by the Division was unreasonable or that the resulting assessment was erroneous. At the hearing, petitioner presented no evidence whatsoever to sustain its burden of proof. No testimony was offered; no books and records were presented to show the amount of gross or taxable sales made during the audit period.

As noted in Conclusion of Law "D", the use of observation tests have been upheld by the courts on numerous occasions and, in addition, the courts have also found that it is reasonable to extrapolate the results of a one-day observation test over a multi-year period. In the present matter, petitioner offered no evidence to prove that the results of the 19-hour observation test performed by the Division in January 2004 were skewed. Absent such evidence, it must be found that the Division properly resorted to an observation test, properly conducted the test and reasonably used the results of the test to estimate taxable sales (and resulting additional tax due) for the audit period.

F. Tax Law § 1145(a)(1)(i) imposes a penalty upon persons who fail to timely file a return or timely pay the tax imposed by Articles 28 and 29 of the Tax Law. The penalty and additional interest may be waived if "such failure or delay was due to reasonable cause and not due to willful neglect" (Tax Law § 1145[a][1][iii]). In determining whether reasonable cause and good faith exist, the regulations provide several specific grounds and also a catch-all which provides

for a finding of reasonable cause based upon any “ground for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay,” demonstrating an “absence of willful neglect” (20 NYCRR 2392.1[d][5]). The taxpayer bears the burden of establishing that the actions were based upon reasonable cause and not willful neglect (*see, Matter of Philip Morris*, Tax Appeals Tribunal, April 29, 1993; *Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992, *confirmed* 193 AD2d 978, 598 NYS2d 360).

Petitioner has offered no evidence upon which a finding of reasonable cause could be made. Moreover, petitioner has failed to prove that the Division’s assessment of omnibus penalty pursuant to Tax Law § 1145(a)(1)(vi) for omission of an amount in excess of 25% of the amount of taxes required to be shown on its tax return was improper. Accordingly, penalties assessed herein are sustained.

G. The petition of Jigar Corporation is denied and the Notice of Determination dated February 17, 2004 is sustained in its entirety.

DATED: Troy, New York
November 30, 2006

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE