Want to Avoid a Messy Sales Tax Audit? Good Recordkeeping is the Key

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Recordkeeping is essential for any restaurant, but recordkeeping for sales taxes is particularly important because of the consequences of not following the law. If mishandled, sales and use taxes can quickly ruin your business. Good recordkeeping practices are your first line of defense.

If you own, operate or even invest in a restaurant, then you simply cannot avoid sales taxes. Sales made by restaurants are subject to tax, and all transactions, both sales *and* purchases, are subject to record keeping requirements imposed by law. Further, sales taxes (like payroll taxes) are trust fund taxes. This means owners, operators, and even investors can be held personally liable for trust fund tax debts of the business. So, the stakes are high. Let's take a brief look at restaurant recordkeeping requirements, and the consequences for failing to live up to them.

A. What Records to Keep?

Sales tax returns are required to report, among other details, total sales, taxable sales, taxable purchases, tax collected, credits, and tax due. Businesses, therefore, are required to keep all records and documentation to enable an auditor to independently verify the information reported on the tax return.

For sales transactions, this means businesses must keep records of every sale, the amount of each sale, the sales tax charged, the sales tax collected, and documentation establishing any applicable tax exemptions. Each sales slip, invoice, receipt, guest check, and cash register tape, among other records, must be kept in an orderly fashion.

Purchase transactions also must be tracked. Records must be maintained to establish the taxable status of all purchases by the business of property or services. Cost of goods sold? Check. Janitorial services? Check. Supplies, including guest checks? Check. Purchase records must substantiate all expenses including whether sales taxes were paid on those purchases or whether use taxes are due. Further, these records should hopefully show that your business expenses bear a reasonable relationship to your sales

By law in New York, records should be kept for a minimum of three years.

B. Point-of-Sale (POS) Systems

If your business uses a POS system, you need to ensure that it is properly set up and accurately recording your transactions. Electronic POS records must permit a direct reconciliation of the business' receipts with the entries in the restaurant's books and records. In other words, you need to maintain auditable internal controls to ensure both the accuracy and completeness of the transactions recorded in the POS system.

the POS is in training mode versus regular functionality.

Any records maintained electronically must be safely stored and readily accessible in the event of an audit.

C. Consequences of Inadequate Recordkeeping

Remember, the law requires that businesses keep accurate records. So, what happens when you are audited? If you have adequate books and records, the auditor will examine those records to determine whether everything was running smoothly and reported properly. Often, that task is difficult enough. But, what happens when you don't have proper recordkeeping and your records are incomplete or inaccurate and don't fully comply with the auditor's demands? Trouble ahead.

Where a business does not have proper records, the law allows the auditor to utilize indirect methods to estimate the tax due from whatever information is available, including reliance upon external indices. This means the auditor can estimate the business' tax bill using various indirect methods. In other words, because you cannot prove what your actual purchases and sales were, the auditor can make an educated guess and then hand you a bill assessing tax, plus penalties and interest.

For example, the auditor could observe the business on a Friday night and project those sales to the entire audit period, even though business is much slower on Monday and Tuesday nighs. The auditor could also examine your rent or utility expense and project what your sales might have been based upon certain industry ratios and averages. Your restaurant's rent may be high and your sales may be slow, but, since you don't have accurate records of your business' actual activities, the auditor is generally allowed to make these types of statistical projections.

If a business does not have adequate records, the business bears the burden of proving that the auditor's projected tax assessment is erroneous. Take note, however, while the auditor is not required to choose the most reasonable method, the method chosen must, in fact, be rationale. While it's an uphill climb, taxpayers can, under the right circumstances, win those fights.[1]

D. It Gets Even Worse: Tax Creditors are Unlike Other Creditors

The failure to maintain proper records can lead to audit methodologies that may produce wildly different findings than the actual books and records would have otherwise shown. Not only does this make the audit difficult, it can lead to a very large tax bill. Often the penalties and interest alone can be substantial.

Further, as mentioned above, many operators don't understand until it's too late that sales-and-use taxes (and payroll taxes) are trust fund taxes, which carry personal liability. That means owners, operators, and even investors can be personally liable for the business' improper sales-and-use tax reporting and compliance. In turn, this can cascade into a series of terrible events including the filing of tax liens, bank levies, wage garnishments, New York driver license suspension, as well as possibly the initiation of a criminal tax investigation or seizure and auction of the business and its assets.

The best way to minimize your exposure is to develop and implement good recordkeeping practices now. Accurate records are not only essential to track profitability, they are necessary to properly track tax compliance. Restaurants have many tax and accounting obligations from local, state and federal governments. It is essential that owners and operators develop a basic understanding of these tax requirements and hire competent and trustworthy advisors to assist them. Taxes are a cost of doing business. While there are lawful ways to minimize them, there is simply no way to avoid them.

Instituting recordkeeping best practices is an investment in your business that will pay dividends for years to come. If you want to discuss your business' tax reporting and compliance, or if you are facing a tax audit or dispute, you can email me at lrothenberg@litaxattorney.com.

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[1] *See, e.g., In re 3152 Restaurant, Inc.*, DTA No. 827174 (N.Y. Division of Tax Appeals, ALJ Unit) (12/28/2017) for a recent taxpayer victory.

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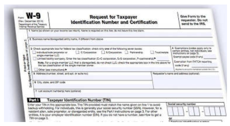

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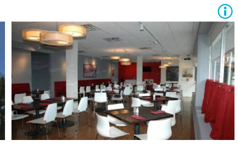

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