

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MARINE MIDLAND BANK, N.A.	:	DECISION
for Revision of a Determination or for Refund	:	DTA No. 807533
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period March 1, 1983	:	
through November 30, 1985.	:	

Petitioner Marine Midland Bank, N.A., One Marine Midland Center, Buffalo, New York 14203 and the Division of Taxation each filed an exception to the determination of the Administrative Law Judge issued on July 16, 1992. Petitioner appeared by James A. Locke, Esq. and Martha L. Salzman, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

Both parties filed briefs on exception. Oral argument was heard on March 25, 1993 which began the six-month time period for the issuance of this decision.

Commissioner Dugan delivered the decision of the Tax Appeals Tribunal. Commissioners Koenig and Jones concur.

ISSUES

- I. Whether the notice of determination issued to petitioner was invalid because it failed to indicate that the tax assessed was estimated as provided for in Tax Law § 1138(a)(2).
- II. Whether the Division of Taxation was authorized by Tax Law § 1138(a)(1) to employ a computer assisted statistical sampling methodology to determine petitioner's sales and use tax liability where petitioner maintained a complete and adequate set of books and records.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Marine Midland Bank, N.A., and the Division of Taxation ("Division") executed a Stipulation of Facts pursuant to 20 NYCRR 3000.7. The stipulated facts have been substantially incorporated into the following Findings of Fact.

Petitioner is a national banking association, with an office at One Marine Midland Center, Buffalo, New York. During the audit period, March 1, 1983 through November 30, 1985, petitioner was engaged in a commercial banking business. Petitioner's taxpayer identification number is 16-1093160. Petitioner is one of the nation's largest banks providing a full range of commercial, corporate, international, retail and fiduciary banking services to corporations, institutions, governments, and individuals. Petitioner has an extensive banking network in New York State with about 300 branch offices and has regional offices in Rochester, Syracuse and New York City. Its headquarters are in Buffalo, New York. Petitioner has numerous automated teller machines ("ATM's") and point of sale electronic banking facilities throughout New York State. Petitioner provides credit cards to consumers in over 40 states through financial institutions affiliated with its Par Agent national credit card program.

As a result of a computer-assisted audit which included the statistical sampling of petitioner's books and records, the Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated February 24, 1988, assessing additional sales and use tax due of \$968,240.69 for the period March 1, 1983 through November 30, 1985 plus a penalty of \$247,469.04 and interest (computed at the penalty rate). All of the additional tax due was related to petitioner's purchases of tangible personal property and taxable services.¹

The notice of determination issued to petitioner contained the following statements:

"The tax assessed above has been estimated in accordance with the provisions of section 1138(a)(1) of the Tax Law." [This statement was preceded by a box.]

¹Petitioner's taxable sales included the sale of checks and checkbook covers and repossessed vehicles and the rental of safe deposit boxes. The audit found no additional tax due in the area of taxable sales.

If the box above is checked see additional information on back of this notice. If the box above is not checked, the tax has not been estimated."

The box referred to on the notice of determination was not checked.

Prior to the issuance of the notice of determination for the audit period, petitioner and the Division agreed to fix the amount of additional tax and interest due on certain AT&T long line telephone charges at \$343,977.81 and \$94,666.49, respectively. Petitioner paid these amounts in February 1988. The Division did not assert a penalty with regard to these transactions because AT&T did not collect tax from any of its customers and petitioner was not aware that the services were subject to tax.

By letter dated June 9, 1988, from Gordon A. Farquahar, Vice President and Manager of Corporate Tax Planning for petitioner, to Michael J. Pistolese of the Division's Buffalo District Office, petitioner remitted \$748,000.00 of the assessed tax and \$256,839.39 of the assessed interest, to be allocated among the quarters included in the audit period. The letter stated, in part:

"Please note that this payment does not constitute a consent to the allegations contained in and/or pertinent to the Notice of Determination and Demand for Payment of Sales and Use Tax Due dated February 24, 1988, and does not constitute an admission or implication that any amount of tax is due or owing for the taxable periods listed above."

In this proceeding, petitioner contests the full amount of the tax assessed for the audit period, \$968,240.69, plus penalty and interest. Accordingly, petitioner seeks a refund of the amount paid, \$1,005,139.39, and cancellation of the remainder of the tax assessment (\$219,940.69).²

²Petitioner timely filed a petition in this matter on November 1, 1989, contesting tax in the amount of \$219,940.69, plus penalty and interest. At hearing, petitioner was granted permission to amend its petition to challenge the validity of the notice of determination, on the ground that the notice failed to indicate that the tax assessed was estimated. By Notice of Motion dated August 29, 1991, petitioner informed the Administrative Law Judge that it would move, on October 21, 1991, for permission to amend its petition a second time to change the amount of tax contested from \$219,940.69 to \$968,240.69. By letter dated October 6, 1991, the Division informed the Administrative Law Judge that it would not oppose petitioner's motion. Petitioner's motion to amend was granted by letter dated April 14, 1992. Petitioner filed a second amended petition on April 20, 1992.

Petitioner's books and records for the audit period are adequate, sufficient and substantially complete and were available for examination by the Division.

Petitioner fully cooperated with the Division throughout the audit. Petitioner did not consent to the Division's use of a computer-assisted statistical sampling method of auditing petitioner for the audit period. The Division never specifically requested petitioner's consent to the use of a computer-assisted statistical sampling audit method or to any other method of auditing petitioner's books and records. Petitioner did not, prior to the concluding conferences for the audit, expressly object to the use of the computer-assisted statistical sampling method of conducting the audit.

THE COMPUTER ASSISTED STATISTICAL SAMPLING AUDIT PROGRAM

There are approximately 500,000 registered sales tax vendors in New York State. The Division classifies between 2,000 and 2,500 of these as "large vendors", those reporting sales tax due of over \$125,000.00 per quarterly sales tax period. The Division conducts 5,000 to 7,000 field audits annually; it seeks to examine the returns of each of the large vendors every three years, with some 450 to 600 such audits scheduled each year. It employs approximately 400 sales tax auditors, each of whom works directly on audit related functions 185 days per year. With this available staff, it would not be possible for the Division to conduct even a small number of large vendor audits which examine each and every transaction on an item-by-item basis.

To carry out its audit function with available staff the Division has developed a variety of audit methodologies. Limited scope audits concentrate on specific areas to audit. Block audits involve the use of a team of auditors for a specified period of time. Computer-assisted audits allow the Division maximum use of the auditor's time. A statistical sampling audit is one type of audit made possible by computer assistance, but all computer-assisted audits are not statistical sampling audits. The statistical sampling method was developed by the staff of the Division's

Electronic Data Processing Systems Audit Bureau ("EDP"), assisted by an independent authority on statistical sampling audits, Herbert Arkin, Ph.D.

The Division presented the testimony of Donald M. Roberts, Ph. D., an expert in the field of statistics and public accounting, hired by the Division to review and evaluate the Division's statistical program in the area of sales tax audits. Dr. Roberts concluded that the Division's statistical sampling methodology conforms to sound statistical principles and that the results of audits conducted using that methodology are statistically valid. Dr. Roberts submitted a report suggesting some changes in the Division's statistical sampling program, but those changes were recommended to improve efficiency and do not affect the validity of the program.

In the course of his testimony, Dr. Roberts described many of the concepts underlying the statistical sampling methodology. Some of his observations are pertinent here. He stated: "Statistical sampling actually is a methodology that allows you to examine all items in a population by selecting just a few." (Transcript at 235.) It differs from a test period audit in at least one significant way. In a test period audit, the results of a block of time (or test period) are projected over a longer period. The accuracy of the results rests upon the representativeness of the test period selected and, consequently, the judgment of the auditor who selected the test period. There is no scientific methodology to assess how well the auditor exercised his or her judgment in selecting the test period. The statistical sampling methodology is based upon mathematical principles and laws of probability and chance and allows for measurement and control of the error factor. The error is quantified in the precision factor.³ Statistical sampling is a particular type of estimating procedure, and it is very unlikely that two samples from a population will yield identical results.

³"Precision" in statistics is a statement of how close the result of a particular sample should be to the result which would be obtained if every item in the "universe" was examined. Given the size of the sample and the magnitude of each error identified, the precision is described as \pm an amount. Sampling error is expressed in terms of percentages, while the precision factor is expressed in dollar value amounts.

The Internal Revenue Service employs statistical methodologies in auditing taxpayers as does the State of Illinois. Dr. Roberts has served as a consultant to both of these jurisdictions. Based on his knowledge and experience, he stated that a 95% confidence level, the level achieved in this audit, is an accepted standard.

Computer-assisted audits are conducted by field audit staff in the Division's district offices with technical assistance from specialists in EDP. EDP staff review the machine sensible electronic data available from a taxpayer's computerized recordkeeping system and determine whether a statistical sampling method can be conducted with the records available from the taxpayer. If a statistical sampling audit is conducted, EDP staff provide the statistical analysis of data produced from a field auditor's review of randomly selected sample items.

The Division also conducts test period audits. The major difference between a test period audit and a statistical sampling audit is that the former involves a test of all records within a portion of an audit period (usually one to three months), while the latter samples randomly-selected items from the entire audit period. The Division does not request the consent of the taxpayer before performing a statistical sampling audit, but it does seek consent to perform a test period audit where it determines that a taxpayer's records are complete and adequate for the purpose of performing a detailed audit. It does not seek consent to a statistical sampling audit because it takes the position that this methodology utilizes all of the taxpayer's books and records.

The Division used a computer-assisted statistical sampling method to audit petitioner's sales tax returns for the audit period. This audit was generally consistent with the Division's procedures for such audits; therefore, a description of the actual audit conducted will also serve to describe the Division's statistical sampling audit program.

AUDIT OF PETITIONER

Potential candidates for computer assisted audits are first identified by the Division's District Office Audit Bureau. These candidates are asked to provide information which allows

the Division to determine whether such an audit is feasible. The most important factor considered by EDP in making such a determination is whether the taxpayer utilizes a computer system which is compatible with the Division's own computer hardware and software systems. In July 1985, petitioner was asked by the Division to complete a Computer Audit Feasibility Questionnaire, which it did. EDP reviewed the completed questionnaire and determined that the Division was able to audit petitioner using computer-assisted techniques.

The sales tax field auditor assigned to this matter, Paul Barto, was contacted by EDP and instructed to schedule a meeting between the Division and petitioner's representatives. That meeting was held on November 26, 1985 at petitioner's offices. The meeting was attended by Mr. Barto, his supervisor, John Neeb, Angelo Gazzo, a second auditor, and Andy Blumbergs of EDP, on the Division's side, and by David R. Sharp, petitioner's Assistant Vice-President, Ida Mae Raoff, Donna Zeller, and Ed Wisniewski representing petitioner. Mr. Blumbergs explained the computer-assisted audit program and the statistical sampling methodology to petitioner's representatives. He was asked several questions which he agreed to respond to in writing. Consequently, by letter dated November 27, 1985, the Division described to petitioner its expected plan for carrying out the computer-assisted audit. In addition, the Division cited to several legal authorities to support its position that under its general authority to inspect and examine a taxpayer's books and records it is authorized to request and examine magnetic tapes, discs, punch cards, computer printouts and any other machine sensible data used to record, consolidate and summarize the taxpayer's accounting transactions. Notably, the Division's letter made no reference to its authority to determine a taxpayer's sales tax liability by means of a statistical sampling methodology.

In accordance with the audit plan outlined in the letter, Paul Barto and John Neeb met with David Sharp on December 10, 1985, at petitioner's offices, to review petitioner's chart of accounts and to identify those most likely to include purchases subject to sales tax. Since petitioner conducted business throughout New York and outside New York, its distribution of

accounts was maintained by cost centers (geographic location or operational units); therefore, the accounts were examined to limit the audit to transactions which occurred in New York. Six asset accounts were selected for audit and over 100 expense accounts.

From its master accounts payable/distribution file, petitioner created and transmitted to the Division audit files on magnetic tape. These files contained a detailed record of every accounts payable transaction made by petitioner during the audit period. The magnetic tape and audit files contained sufficient information to allow retrieval of microfilm copies of the original source documents for each transaction (excluding April 1984).

The audit files received from petitioner were first converted from the tape format in which they were received to a format compatible with the Division's computer system and software. From the audit files, the Division created two separate files (referred to as "universe" files), one file for assets and the other for recurring expense purchases. This was done because the Division planned to, and did, audit each of these areas separately. EDP then generated a number of summary reports. A location and cost summary report was generated to identify all locations in New York where petitioner made purchases subject to sales tax. An "account summary" report was produced which summarized the total dollars and transaction volume in each separate account. A "data summary" account was produced which summarized the same information on a monthly basis. The Division used the account summary and data summary analyses to verify the accuracy of the contents of the audit files.

The summary reports were transmitted to Mr. Barto who compared the amounts shown to petitioner's general ledger. This comparison is made as one step in a computer-assisted audit to ensure that a taxpayer's records are complete and reliable. In this case, there were no significant discrepancies and Mr. Barto so informed EDP.

After verifying the accuracy of the audit files, EDP summarized the transactions in the expense universe and the asset universe by dollar ranges ("strata") and determined the total number of transactions ("population") within each dollar range ("stratum"). It then produced

"profile reports" which show the number of strata in each universe (9 actual strata in both the expense and asset universes); the actual dollar ranges in each of the 9 strata (\$0 - \$100; \$100 - \$500; etc.); the number of transaction items in each dollar range or stratum; and the total dollar value of all transaction items within a stratum. The computer calculated other factors from this information, e.g., the average dollar value of each transaction within a stratum; the median dollar value of each transaction within a stratum, the standard deviation, and the ratio of the dollar value of all transactions within a stratum to all transactions in the universe (expressed as a percentage). The profile reports included an unnumbered stratum for credit transactions.

The profile report aids EDP in determining which strata are to be audited in detail and which are to be audited by statistical sampling. It also provides information which EDP uses to adjust the dollar range and sample size if necessary. In this case, EDP chose to review in detail all of the expense transactions in stratum 9 (\$20,000.00 - \$99,999,999.99) and all of the asset transactions in strata 7, 8, and 9 (\$7,500.00 - \$99,999,999.99), and all credit transactions. Items in all other strata were statistically sampled. The selection of particular items for the statistical sample was made by use of a random number generating computer program.

The next step in auditing petitioner's records was the preparation of two "pull reports", one for expenses and one for assets. The pull reports list the specific sample items to be examined by the auditor along with information needed to retrieve those items from the taxpayer's files, in this case: the transaction date, vendor name, voucher number, cost center identification number, account number and the amount of the transaction.⁴ The pull reports also have blank spaces for information to be inserted by the field auditor. On the pull reports, credit transactions are noted as stratum 11. The pull reports were forwarded to the field auditor and a copy of each was presented to petitioner.

⁴Petitioner maintains its accounts by type of transaction, and petitioner's accounting system distributes items on a single invoice to the appropriate account. The transactions audited by the Division (the sample items) were the individual items distributed to an account, not an entire invoice. Each item is identified by a voucher number which allows for the retrieval of source documents related to the item.

Petitioner maintained copies of original source documents, in this case sales invoices, vouchers, purchase orders and other supporting documentation, on microfilm. The auditor examined over 3,082 purchase items in the asset universe and 3,811 purchase items in the expense universe, using petitioner's microfilm and microfilm reading equipment. A transaction which does not comply with the provisions of the sales tax law is referred to by the Division as an "exception item". When the auditor's review of a transaction indicated that it was a potential exception item, he made notations on the pull report indicating the amount of the transaction, the location code, the proper tax rate and the amount of tax due. The auditor here also provided a brief description of the item subject to tax (e.g., credit report, rubbish disposal, paint walls and ceilings). Where tax was properly charged, the auditor placed a zero on the pull report. The auditor made hard copies of the invoices on which exception items appeared using the microfilm equipment. The exception items were then reviewed with petitioner's staff and petitioner was provided an opportunity to provide further documentation to assist the Division in determining whether additional tax was owing on the transaction. The auditor also researched the proper treatment of potential exception items using publications of the Division and administrative law decisions. If a potential exception item was determined to be not subject to additional tax, the amount of the transaction was changed to zero on the pull report.

The statistical sample included a number of items for charges by AT&T for long line telephone service within New York State. Because of the large amount of tax related to this one category, petitioner requested that the AT&T charges be addressed separately. This was accomplished by treating all AT&T items in the statistical sample as no change items, and generating a separate listing of the AT&T vouchers. Petitioner then performed its own analysis of the taxable charges included in the overall AT&T charges. Petitioner's calculation was accepted by the Division as the basis for determining the amount of tax due with respect to the AT&T charges.

When completed by the auditor, the pull reports were forwarded to EDP for summarization and analysis. The EDP statistical program generates several summary reports, including a listing of exception items, a summary of the statistical report and explanatory materials. These reports were prepared in this case and sent to petitioner for review. The following charts were prepared from the summaries prepared by EDP (Exhibit "X") and set forth partial results of the statistical sampling audit.

Expenses

<u>Stratum Range</u>	<u>Stratum Size⁵</u>	<u>Sample Size</u>	<u>Dollar Value of Differences⁶</u>	<u>Mean⁷</u>	<u>Point Estimate⁸</u>
(1) 00 - 99.99	257909	0	\$ 0	0	\$ 0
(2) 100 - 499.99	158624	350	242.32	.692343	109,822.22
(3) 500 - 999.99	37629	350	595.91	1.702600	64,067.14
(4) 1,000 - 2,499.99	19823	350	2,148.05	6.137286	121,659.42
(5) 2,500 - 4,999.99	8267	250	3,597.59	14.390360	118,965.11
(6) 5,000 - 7,499.99	3310	250	5,148.49	20.593960	68,166.01
(7) 7,500 - 9,999.99	1470	250	4,640.47	18.561880	27,285.96
(8) 10,000 - 19,999.99	2236	250	13,195.65	52.782600	118,021.89
(9) 20,000 - 99,999,999.99	1511	1511	173,517.98	114.836519	173,517.98
Credits	11645	250	0	0	0
Totals	502,424	3,811	\$203,086.46	1.595278 ⁹	\$801,505.95

Assets

Dollar

⁵Also referred to as "population".

⁶Total dollar value amount of additional tax due found by examination of the individual sample items.

⁷Arithmetic average calculated by dividing the "Value of Differences" within a stratum by the sample size.

⁸Estimated additional tax due calculated by multiplying the stratum size times the mean.

⁹A weighted average.

<u>Stratum Range</u>	<u>Stratum Size</u>	<u>Sample Size</u>	<u>Value of Differences</u>	<u>Mean</u>	<u>Point Estimate</u>
(1) 00 - 99.99	298	0	\$ 0	0	\$ 0
(2) 100 - 499.99	1357	0	0	0	0
(3) 500 - 999.99	1823	250	753.84	3.015360	5,497.00
(4) 1,000 - 2,499.99	2832	250	1,980.75	7.923000	22,437.94
(5) 2,500 - 4,999.99	1840	250	2,793.40	11.173600	20,559.42
(6) 5,000 - 7,499.99	818	250	5,128.31	20.513240	16,779.83
(7) 7,500 - 9,999.99	483	483	14,637.50	30.305383	14,637.50
(8) 10,000 - 19,999.99	630	630	21,071.85	33.447381	21,071.85
(9) 20,000 - 99,999,999.99	766	766	179,639.25	234.51992	179,639.25
Credits	203	203	0	0	0
Totals	11,050	3,082	\$226,004.90	25.395728	\$280,622.79

EDP determined that the overall relative sampling error in the expenses category was 13.6760%, and in the assets category, it was 5.0016%. The Division subtracted \$109,614.24 and \$14,035.52 from the point estimates on expenses and assets, respectively, to account for this sampling error. These dollar value amounts are referred to as the "precision factor". In this way, the Division estimated additional tax due on expenses of \$691,891.71 and additional tax due in the area of assets of \$266,587.27.

The parties stipulated to the following facts:

"The...Division determined taxes claimed to be due in this matter at the 95% confidence level, with a one-sided test, and assessing at the lower end. In statistics 'confidence' describes a degree of certainty that an amount determined from analysis of a random sample plus or minus the 'precision' would actually include the 'true' result. When the 'confidence level' is 90%, 90 samples out of 100 samples of the same size from the same 'universe' would include within the 'precision' range the 'true' result which would be obtained if all items in the 'universe' were examined and the examination was free of transcription inaccuracies or other human error. A two-sided confidence level for a result indicates that result value with a range plus or minus the 'precision' amount. A 90 percent two-sided confidence is equivalent to a 95 percent one-sided confidence. A 95 percent one-sided confidence at the lower limit of the precision range indicates that the true result may be higher than the result from a given sample for 95 percent of samples of the same size and may be lower for 5 percent of samples of the same size." (Stipulation ¶ 11[F][15].)

The 95% confidence level achieved on this audit allows the Division to predict that there is a 95% probability that the amount of tax determined on audit is less than the amount actually due and a 5% probability that the amount of tax determined on audit is more than the amount actually due.

The month of April 1984 did not appear on the magnetic tapes provided to EDP. Consequently, the Division reviewed in detail all of petitioner's April 1984 accounts payable transactions recorded in the specific expense and asset accounts selected for audit, within stratum 9 for expense accounts and strata 7, 8, and 9 for asset accounts. From this examination, the Division determined additional tax due for April 1984 of \$2,440.13 in the area of expense purchases and \$3,685.94 in the area of asset purchases. These are exact amounts not obtained by statistical sampling or any other method of estimating tax due. The Division estimated additional tax due of \$16,860.83 based on the results of the statistical sampling audit for this period. Total tax due in April 1984 was determined to be \$22,986.90.

An audit closing conference was held at petitioner's offices on February 1, 1988. At that conference, petitioner's representatives expressed some concerns about the use of account distributions, rather than invoices, as the sample unit. Petitioner offered several alternative calculations of tax due based on invoice amounts, but these alternatives were rejected by the Division as not statistically valid.

CHALLENGES TO THE AUDIT

In reviewing credit transactions, the auditor did not treat any credit as an exception item unless the corresponding debit transaction was included in the sample items. He based this approach on his experience with other audits. This was an incorrect method of accounting for credit transactions in a statistical sampling audit, and it was not discovered during the course of the audit or as a result of audit conferences with petitioner conducted before the assessment was issued. The auditor examined 203 credit transactions in the asset universe and 250 in the expense universe. All of these were found to be no change or nonexception items.

Because the statistical sampling method treats all transactions within the universe population as included in the audit, any credit transaction in which petitioner received credit for an item other than the correct amount of tax, should have been noted as an exception item. One credit transaction in this audit serves to demonstrate the proper treatment of credit transactions in a statistical sampling audit.

A credit memo from John W. Harland and Co. shows delivery of merchandise in Erie County, which imposes sales tax at the rate of 7%. The credit memo shows the cancellation of a sale in the amount of \$15.00 with a tax of \$1.00. The correct amount of tax was \$1.05. Although this particular sale was not included in the expense items sampled, statistical principles would state that the underpayment of \$0.05 was picked up on the debit transaction; therefore, the auditor should have increased the amount of the credit by the amount of the error, \$0.05.

Petitioner identified four credit transactions in the audit sample which should have been treated as exception items.

(a) An invoice from Mandas & Orr shows a charge to petitioner of \$2,800.00 for the installation of an ATM enclosure. No sales tax was charged. Petitioner issued one check to pay the invoice and then issued an internal credit to cancel the check. Petitioner then issued a new check to pay the \$2,800.00 due the vendor. Petitioner's internal credit in the amount of \$2,800.00 was included in the pull report of asset purchases to be reviewed in detail. The auditor treated the transaction as a nonexception item, with no change in the amount of tax due. The credit transaction should have been treated as an exception item, entitling petitioner to a credit in the amount of the tax due.

(b) A credit memo from Action Data Systems to petitioner indicates that it is crediting petitioner for one "PC Focus" shipped to petitioner in New York City. The total amount credited is \$1,369.25, which includes (in addition to a miscellaneous charge of \$5.00) a credit of \$89.25 representing a 7% sales tax on a credit of \$1,275.00. The auditor treated the transaction as a nonexception item. Because the item was shipped to New York City, the correct tax rate was

8.25%. Thus, this credit transaction should have been treated as an exception item, entitling petitioner to a credit in an amount correcting the tax charged.

(c) A credit invoice from Computerland indicates that it was issued to credit a sales invoice for an item that was to have been delivered to petitioner in New York City. The total amount credited is \$1,177.00 which includes a charge of \$1,100.00 and sales tax of \$77.00. The sales tax rate imposed is 7%. Since the item was to be delivered in New York City, the correct rate was 8.25%. The auditor treated the credit transaction as a nonexception item. It should have been treated as an exception item correcting the amount of tax charged.

(d) A credit invoice from New Jersey Office Supply to petitioner indicates that petitioner was being credited for charges for a file transfer. The item was delivered to petitioner in New York City and tax should have been charged at the rate of 8.25%. The total amount credited to petitioner on the credit invoice is \$180.69 which includes a credit of \$12.21 for sales tax (indicating a tax rate of 7.25%). The auditor treated this credit transaction as a nonexception item. It should have been treated as an exception item, entitling petitioner to an additional credit for the amount of the undercredited tax.

Norman Ayers, a data processing systems analyst in EDP, testified that the audit results should be adjusted to rectify errors made with regard to credit transactions. The Division appended to its brief two alternative methodologies for treating the error. They are included in Appendix A of this determination. There is no basis in the record for preferring one alternative over the other, and the Division has not argued in favor of either alternative.

After total additional tax due for an audit period is calculated, it is necessary to allocate the total to quarterly sales tax periods. This allocation will affect the amount of penalty and interest owed by the taxpayer. At the request of auditors in the field, EDP developed a formula for allocating the tax to quarters. At hearing, Mr. Ayers was unable to recall the methodology used to allocate the tax amount but later obtained the information from other persons in his office. The formula used by the Division was described as follows: additional tax due per quarter for

sampled stratas is divided by total additional tax due for the audit period in sampled stratas and multiplied by projected tax due for sampled stratas minus precision. It is petitioner's position that this "is not an accurate method of allocating the estimated tax because it allocates an extrapolated tax based on the ratio of unextrapolated tax, [and i]t would be more accurate to base the allocation on the extrapolated tax within a quarter" (Petitioner's Brief at 49, emphasis in original).

The issues raised with respect to the Division's treatment of the credit transactions and the allocation of tax to quarters were not raised by petitioner during the course of the audit. Petitioner first became aware that the Division's treatment of these aspects of the audit might be erroneous after speaking to a consultant hired by petitioner's representatives in preparation for hearing.

Petitioner pointed to one debit transaction which it believes was treated erroneously by the auditor. An invoice from Angiers Business Machines, Inc. indicates that the vendor charged petitioner for three typewriters delivered to petitioner in Charlotte, North Carolina. The amount of the charge was \$1,385.76 which includes sales tax of \$101.76. Since the typewriters were delivered out of State it appears that no sales tax was due. The auditor included this item in the statistical sampling as a nonexception item with no change in tax due.

AGREED UPON ADJUSTMENTS

Prior to the hearing in this matter, petitioner and the Division agreed to adjust the amount of tax determined to be due by treating as nonexception items certain transactions that the Division had formerly included in the statistical sampling data as exception items:

(a) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to two invoices from B. Angell & Associates, Inc. ("Angell") to petitioner charging petitioner for marketing surveys. At petitioner's request, Angell performed a study of New York consumer reactions to various bank premiums as promotions and a study of New York State customers' financial delivery habits. The studies were performed only for petitioner, were

conducted as a result of petitioner's request for the information and Angell was not entitled to share the results of the studies with others. Petitioner and the Division have agreed that the charges for these studies constitute a personalized or individual information service excluded from sales tax under Tax Law § 1105(c)(1) and have agreed to adjust the tax determined to be due by treating these two transactions as nonexception items, not subject to additional tax due.

(b) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to an invoice from Digi Link Co. ("Digi Link") to petitioner. After the issuance of the notice of determination, petitioner provided additional information demonstrating that petitioner accrued and paid New York use tax in the amount of \$754.88 with respect to the Digi Link invoice. Petitioner and the Division have agreed to adjust the tax determined to be due by treating this transaction as a nonexception item, not subject to additional tax due.

(c) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to an invoice from Industrial Valley Bank ("IVB") to petitioner. Petitioner had developed a computer software program, called Trendfinder, and asked IVB to be a test site for the use of the program. Petitioner agreed to reimburse IVB for computer hardware which IVB purchased for use with the program. The invoice from IVB to petitioner is the bill for such reimbursement. The computer hardware was purchased and delivered to IVB in Pennsylvania. Although petitioner reimbursed IVB for the hardware, the hardware remains in Pennsylvania in the possession of IVB (now Fidelity Bank). Petitioner and the Division have agreed to adjust the tax determined to be due by treating this transaction as a nonexception item, not subject to additional tax due.

(d) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to an invoice from Brennan Bros. Co., Inc. ("Brennan Bros.") to petitioner. Brennan Bros. was charging petitioner for material and labor to replace 35 to 40 feet of a 4-inch diameter sewer pipe from the front of petitioner's branch office in Wappinger Falls, New York to the street. The invoice includes a written request to "Please Forward Certificate of Capitol [sic]

Improvement". The Division included this transaction in the statistical sampling data as an exception, subject to additional tax due. Petitioner and the Division have agreed to adjust the tax determined to be due by treating this transaction as a nonexception item, not subject to additional tax due.

Petitioner and the Division agreed to adjust the amount of penalty at issue with respect to the tax on amounts New York Telephone charged petitioner for certain private lines and other intrastate telephone services and on the amount which American Bell charged petitioner for "INST WIRE - FIRM BID". The Division originally included these transactions in the statistical sampling data as exceptions, subject to additional tax due and also included the transactions as exceptions for the purpose of computing the penalty, including interest at the penalty rate. Petitioner and the Division have agreed to treat this item as a nonexception item, not subject to additional tax due for the purpose of computing the penalty imposed on any additional tax determined to be due, and otherwise as an exception item, subject to additional tax due.

The Division assessed additional tax in the amount of \$1,798.27 with respect to charges collected by petitioner's landlord for the operation of a Cardox system and for materials and overtime labor for the operation of the heating, ventilation and air conditioning ("HVAC") system at Marine Midland Center in Buffalo. Petitioner's landlord controlled and operated the Cardox system and charged petitioner for its operation. Under the terms of the lease between petitioner and its landlord, the landlord is required to furnish petitioner with "space heating and cooling as normal seasonal changes may require to provide reasonable comfortable space temperature and ventilation for occupants of the Premises under normal business operation, daily from 8:00 a.m. to 6:00 p.m. (Saturdays to 1:00 p.m.), Sundays and holidays excepted." Under the terms of the lease, petitioner is required to pay the landlord if it requires "air conditioning (during the air conditioning season) or heating or ventilation during any season outside the hours and days" described above. Petitioner and the Division agreed to treat charges from petitioner's

landlord for the operation of a Cardox system and for materials and overtime labor for the HVAC system as follows:

- (a) as nonexception items, not subject to additional tax due, if Debovoise & Plimpton, the plaintiff in a declaratory judgment action against the Department, Debovoise & Plimpton v. New York State Department of Taxation and Finance (565 NYS2d 973 [Sup Ct NY County 1991]) (the "Action"), is successful in obtaining a final judicial determination that overtime HVAC services incidental to the provision of rented premises are not subject to sales tax;
- (b) as exception items, subject to additional tax due, if Debovoise & Plimpton is not successful in obtaining such a determination; and
- (c) in either event, as nonexception items, not subject to additional tax due, for the purpose of computing the penalty (including interest at the penalty rate) imposed on petitioner on any tax determined to be due.

For the purposes of the stipulation between petitioner and the Division, a "final judicial determination" means a decision of a New York court having jurisdiction over the Action and whose decision is not subject to appeal to another New York State court; or, if subject to such appeal, has not been appealed within the time required for an appeal; or, if appealed, such appeal has been dismissed.

The Division originally included these transactions in the statistical sampling data as exceptions, subject to additional tax due and as exceptions for the purpose of computing the penalty, including interest at the penalty rate.

PENALTY ITEMS IN DISPUTE

Prior to the hearing in this matter, petitioner and the Division stipulated to certain facts with respect to transactions which the Division treated as exceptions subject to additional tax due and as exceptions for the purpose of computing penalty, including interest at the penalty rate. Petitioner agrees to the treatment of these transactions as exception items, subject to additional

tax due. Petitioner seeks abatement of penalty on each of the following items and seeks to have each of the items treated as nonexception items for the purpose of computing penalty, including interest at the penalty rate.

(a) Certain invoices reviewed by the Division were for information services, such as consumer surveys, credit reports and computer software, and advertising-related services.¹⁰ The consumer survey information which each vendor sold to petitioner was obtained from a common data base from which the vendor could provide information to its other customers. The invoices for advertising-related services include charges for the production of employee training materials, including videotapes, training books and quizzes, used exclusively for training petitioner's personnel. One of the invoices from Product Knowledge Associates was for the creation of a Student Money Book which was designed to solicit student business and provide students with information regarding money management and other related topics. Petitioner initially treated the transactions in question as charges for personal information and advertising services which are exempt from sales tax but has since conceded that the charges were for taxable services. Petitioner agrees with the treatment of these transactions as exception items, subject to additional tax due, but disagrees with the treatment of these transactions as exception items for the purpose of computing penalty.

Petitioner did not believe these charges were subject to tax because it believed, upon initial review, that the services purchased were in the nature of personal information services which were not taxable, or were creative-type advertising services as opposed to services resulting in the production of tangible personal property. Accordingly, petitioner believed the transactions were not subject to tax. Petitioner states that the sales tax treatment of information services is a confusing area of law and believes that such confusion was the cause of the error.

¹⁰A list of the invoices actually reviewed by the Division was submitted in evidence as Exhibit 3-G. The list does not show the type of service or merchandise actually purchased.

(b) On certain vendor invoices listed in Exhibit 3-J or on accompanying papers, petitioner paid no sales tax because, at the time of purchase, it believed that the work performed by the vendor constituted a capital improvement. Petitioner has since conceded that such work did not constitute capital improvements. Petitioner agrees with the treatment of these transactions as exception items, subject to additional tax due, but seeks abatement of penalty and requests that they be treated as nonexception items for purposes of calculating penalty due.

Each of the vendor invoices in question includes the statement "capital improvement", "CI", or a request that a capital improvement certificate be returned to the vendor. It is not apparent from the face of any of the invoices that the work done was not a capital improvement. Petitioner was confused about the distinction between a capital improvement and a taxable repair or maintenance. For example, the Division treats the installation of coax cable between floors as a capital improvement, exempt from sales tax, but treats the installation of coax cable within a particular floor as taxable. Since petitioner found the area confusing, it relied on the contractor to properly determine whether the transaction was a capital improvement.

(c) Vendor invoices (copies of which are included in Exhibit 3-K) were actually reviewed by the Division as part of the audit. These were primarily charges by Reuters Limited for what appear to be financial information services. On each invoice, the vendor charged sales tax on a portion of the amount it charged petitioner for property or services, but not on the total amount. Petitioner initially treated the amounts for which the vendor did not charge sales tax as exempt from sales and use tax but has since conceded that such amounts are subject to sales and use tax. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty (including interest at the penalty rate). Petitioner asserts that it reasonably relied on its vendors to determine the taxable status of the items sold by the vendors. In light of the fact that these vendors collected tax on a portion of the charges set forth on the invoices, petitioner believed that the vendors had a basis for determining that some, but not all, of the charges were exempt from tax.

(d) In 1985, the sales and use tax rate in Erie County, New York increased from 3% to 4%. On the invoices listed on Exhibit 3-L, the vendor charged petitioner, and petitioner paid, the former New York State and Erie County combined sales tax rate of 7% instead of the 8% rate which should have been charged and paid. The Division included these transactions in the statistical sampling data as exceptions, subject to additional tax due and as exceptions for the purpose of computing the penalty, including interest at the penalty rate. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty. The change in the Erie County sales tax rate took effect very quickly, within one or two weeks of when the rate increase was authorized. Given the short time period within which the change became effective, petitioner believes the failure of its accounts payable system to account for the change was reasonable.

(e) The invoices listed on Exhibit 3-N were reviewed by the Division and were from vendors charging petitioner for the installation of coax cable. The Division assessed tax on amounts which petitioner paid for the installation of coax cable on a particular floor but did not assess tax on amounts which petitioner paid for the installation of coax cable between floors. Petitioner initially treated the installation of coax cable on a particular floor as a capital improvement but has since conceded that such installation is not a capital improvement. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty (including interest at the penalty rate). Coax cable is installed in channels that run underneath the floor and is used to connect computer terminals and personal computers to other data processing equipment. Petitioner did not pay sales and use tax with respect to the installation of the coax cable because it viewed the installation as a permanent installation that would be left undisturbed.

(f) The invoices listed on Exhibit 3-O were reviewed by the Division and were from vendors to petitioner for the installation of ATM enclosures. Petitioner initially treated the installation of such enclosures as capital improvements but has since conceded that the

enclosures are not capital improvements. In many cases, the vendor indicated that the work done constituted a capital improvement. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty (including interest at the penalty rate). ATM enclosures are aluminum and glass or plexiglass enclosures erected to protect customers from rain and to provide some degree of security. Some of them include devices which allow a customer to gain access to the ATM enclosure by inserting a card with a magnetic strip. The enclosures are bolted to the ground and they generally appear to be a part of the building. Petitioner did not pay sales or use tax with respect to the installation of ATM enclosures because it believed that the enclosures were capital improvements.

(g) The Division reviewed the invoices listed on Exhibit 3-P on which the vendor charged petitioner for the installation of bandit barriers. A bandit barrier is a board, usually made of plastic or plexiglass, which is installed vertically over a bank teller counter to protect bank tellers. Petitioner initially treated the installation of bandit barriers as capital improvements because of their permanent nature and because they would not normally be disturbed. Petitioner concedes that the installation of the bandit barriers did not constitute capital improvements, but disagrees with the treatment of these transactions as exception items for the purpose of computing penalty.

(h) The invoices, copies of which are included in Exhibit 3-Q, were actually reviewed by the Division as part of its audit of petitioner. They are charges from petitioner's landlord for various services, such as repair of doors, light bulb replacement, refurbishing chillers, providing an engineer to control the air conditioning system in petitioner's computer room and making and installing signs and shelves. Petitioner initially treated the charges as additional rent under a lease of real property and not subject to sales tax but has since conceded that such charges are subject to sales tax. Because it was the landlord's responsibility for performing work, such as repairing doors, replacing light bulbs and installing signs and shelves, as contained in the lease agreement, petitioner believes that it was reasonable to conclude that the charges for such work

constituted additional rent payments under a lease of real property and were not subject to sales and use tax.

(i) One of the invoices reviewed by the Division was an invoice from VISA U.S.A. Inc. ("VISA") to petitioner for credit card terminals. The invoice was the first invoice petitioner received from VISA for credit card terminals. Petitioner disagrees with the treatment of this transaction as an exception item for the purpose of computing the penalty (including interest at the penalty rate), but otherwise agrees to the treatment of this transaction as an exception item.

Petitioner's accounts payable function is divided into groups with a number of clerks and a supervisor in each group. The supervisors report to the manager of accounts payable. The manager of accounts payable has publications of the Department of Taxation and Finance available to him to determine whether an item is subject to sales tax. Petitioner has its own reference manual which is used to determine the taxability of specific items. If the manager of accounts payable has questions about the proper application of the Tax Law, he reviews them with petitioner's tax manager.

OPINION

We deal first with the exception of the Division in this proceeding.

The Administrative Law Judge determined that the Division of Taxation and the Division of Tax Appeals are bound by the doctrine of stare decisis to follow the Appellate Division Third Department's decision in Matter of Chartair, Inc. v. State Tax Commn. (65 AD2d 44, 411 NYS2d 41) and the numerous cases which follow it. In Chartair, the Court stated that:

"[a]lthough there is statutory authority for the use of a 'test-period' to determine the amount of tax due when a filed return is incorrect or insufficient (Tax Law, § 1138, subd. [a]), resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit [cites omitted]. However, if records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent become arbitrary and capricious and lack a rational basis (see, Matter of Babylon Milk & Cream Co. v. Bragolini, 5 AD2d 712, 169 NYS2d 124, affd 5 NY2d 736, 177 NYS2d 717,

152 NE2d 672)" (Matter of Chartair, Inc. v. State Tax Commn., supra, 411 NYS2d 41, 43, emphasis added).¹¹

Based on her analysis of Chartair and its progeny, the Administrative Law Judge rejected the Division's assertion that the statistical sampling methodology employed to estimate petitioner's tax liability meets the principles of Chartair. The Administrative Law Judge concluded that the "Division's resort to a statistical sampling audit method in the face of complete and adequate books and records and without the consent of petitioner was not authorized by Tax Law § 1138(a)(1)" (Determination, p. 46).¹²

¹¹The Administrative Law Judge aptly summarized the rubric for the conduct of sales tax audits by the Division as follows:

"[b]ecause the statutory authority to determine a taxpayer's sales tax liability by estimate procedures rests upon a finding that the taxpayer's books and records are inadequate to conduct a complete audit, the Division is required to first request (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Rest. v. Chu, 134 AD2d 51, 522 NYS2d 978, 979-980) 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, 828, lv denied 71 NY2d 806, 530 NYS2d 109), in order to determine from verification drawn independently from within these records whether they are sufficient to support a complete audit (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44 NY2d 645, 406 NYS2d 1025). If the Division's examination establishes that the taxpayer's records are adequate and complete, the taxpayer is entitled to have its assessment calculated based upon a detailed audit of those records (Matter of Kennedy & Co. v. Chu, 125 AD2d 773, 509 NYS2d 199; Matter of Allied New York Servs. v. Tully, 83 AD2d 727, 442 NYS2d 624; Names in the News v. New York State Tax Commn., 75 AD2d 145, 429 NYS2d 755; Matter of Chartair, Inc. v. State Tax Commn., supra)" (Determination, p. 32).

¹²Tax Law § 1138(a)(1) provides, in pertinent part, as follows:

"[i]f a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ."

On exception, the Division asserts that the doctrine of stare decisis does not require the Tribunal to follow the Chartair decision. The Division relies on dicta¹³ in Matter of Mercy Hosp. of Watertown v. New York State Dept. of Social Servs. (79 NY2d 197, 581 NYS2d 628) where the Court of Appeals rejected the Appellate Division's application of Chartair to Medicaid audits and sustained the use of statistical sampling by the Department of Social Services for audit of the Medicaid program under the Social Services Law. In doing so, the Court stated that it "has not passed on the validity of the Third Department's construction of Tax Law § 1138(a) and we do not do so now" (Matter of Mercy Hosp. of Watertown v. New York State Dept. of Social Servs., supra, 581 NYS2d 628, 633). In a footnote, the Court refers to Matter of Grant Co. v. Joseph (2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869) and states that "[d]icta in that case runs counter to the Third Department's strict approach to the use of test period audits" (Matter of Mercy Hosp. of Watertown v. New York State Dept. of Social Servs., supra, 581 NYS2d 628, 633, fn. 5). The Court then refers to a statement in the Grant case that "[e]ven when an item-by-item audit is possible, and it was not here, there is no inflexible requirement that [it be used]" (Matter of Mercy Hosp. of Watertown v. New York State Dept. of Social Servs., supra, 581 NYS2d 628, 633, fn. 5). The Division articulates its position as follows:

"[t]he issue of the validity of statistical sampling audit conducted under the authority of Tax Law § 1138(a)(1) was not before the Court of Appeals in either Grant v. Joseph, supra, or Mercy Hospital, supra. However, in Mercy Hospital, the decision below [in the Appellate Division] relied on Chartair and other cases grounded on it. Accordingly, the Court's comment citing Grant v. Joseph in the footnote in Mercy Hospital, was neither gratuitous nor casually expressed and leads to the conclusion that neither the doctrine of stare decisis nor the Division's argument grounded on dicta precludes examining the doctrine of Chartair, supra, in light of the reasoning of the Court of Appeals in Mercy Hospital and Grant v. Joseph" (Division's brief on exception, p. 26).

¹³Dicta is defined as "[o]pinions of a judge which do not embody the resolution or determination of the court. Expressions in court's opinion which go beyond the facts before court and therefore are individual views of author of opinion and not binding in subsequent cases" (Black's Law Dictionary 408 [5th ed 1979]).

The Division also asserts that the statistical sampling audit method used by it fits the principles of Chartair because it uses all of petitioner's books and records as the population for drawing the "random sample" to make its estimate for petitioner's tax liability (Division's brief on exception, p. 19). The Division asserts it may use statistical sampling to estimate petitioner's tax without petitioner's consent.

Petitioner, in response to the Division's exception, asserts that the determination of the Administrative Law Judge was correct in relying on Chartair and that the Division was without statutory authority to estimate petitioner's tax through the use of a statistical sampling audit methodology or any other methodology other than a detailed audit of the actual records without petitioner's consent.

We affirm the determination of the Administrative Law Judge.

First, this Tribunal is bound by the Appellate Division decision in Chartair under principles of stare decisis.¹⁴ We rely on Mountain View Coach Lines v. Storms (102 AD2d 663, 476 NYS2d 918) where the court stated that:

"[t]he Appellate Division is a single statewide court divided into departments for administrative convenience [cites omitted] and, therefore, the doctrine of stare decisis requires trial courts in this department [the Second Department] to follow precedents set by the Appellate Division of another department until the Court of Appeals or this court [the Appellate Division Second Department] pronounces a contrary rule [cites omitted]."

In our view, the rule applicable to trial courts is applicable to this Tribunal. The facts in this case are the same as the relevant facts in Chartair; namely, (1) petitioner maintained complete books and records from which a complete audit could be done to determine petitioner's exact tax liability, and (2) the Division used an audit methodology which estimated petitioner's tax liability.

¹⁴Stare decisis, briefly, is the doctrine "that, when [the] court has once laid down a principle of law as applicable to a certain state of facts, it will adhere to that principle, and apply it to all future cases, where facts are substantially the same" (Black's Law Dictionary 1261 [5th ed 1979]).

As Justice Scalia noted in his concurring opinion in Quill Corp. v. North Dakota (US, 112 S Ct 1904, 1922):

"[w]e have recently told lower courts that '[i]f a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [they] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.' Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 484 (1989)."

Thus, since neither the Court of Appeals nor the Appellate Division have overturned Chartair, it is binding on this Tribunal.

Second, we find the Division's inferences from the dicta in Mercy Hospital, a non-tax case which refers to dicta in Grant, a case factually different from the case at hand, less than persuasive reasoning for us to change our interpretation of section 1138(a) which is based on Chartair (see, Matter of Field Delivery Serv. v. Roberts, 66 NY2d 516, 498 NYS2d 111 [when an agency determines to alter its prior stated course, it must set forth its reasons for doing so]).¹⁵

The fact of the matter is that the Appellate Division in Chartair relied upon its prior decision in Matter of Babylon Milk & Cream Co. v. Bragalini (*supra*). Babylon involved the highway use tax which has provisions analogous to the sales tax concerning record keeping and the Division's authority to estimate tax where returns are insufficient or unsatisfactory.¹⁶

¹⁵The Tribunal has followed Chartair in numerous cases (see, e.g., Matter of A & J Parking Corp., Tax Appeals Tribunal, April 9, 1992; Matter of M & B Appliance, Tax Appeals Tribunal, April 9, 1992; and Matter of Spallina, Tax Appeals Tribunal, February 27, 1992).

¹⁶Tax Law § 507 provides in part that:

"[e]very carrier . . . shall keep a complete and accurate daily record which shall show the miles traveled in this state . . . and such other information as the [Division] may require."

Tax Law § 510 provides in relevant part that:

"[i]n case any return filed . . . shall be insufficient or unsatisfactory to the [Division], or if no return is made for any period, the [Division] shall determine the amount of tax due from such information as is available to the [Division]."

The Appellate Division held that there "was no justification . . . for the use of a percentage formula [a test period audit] to estimate the amount by which the tax was understated, in view of the fact that all the records were available and the exact amount could have been determined therefrom" (*Matter of Babylon Milk & Cream Co. v. Bragalini, supra*, 169 NYS2d 124, 126, emphasis added). The Court of Appeals affirmed without opinion. Thus, while the Court of Appeals has not considered whether section 1138(a) limits the use of test period audits, it has considered the same issue in the context of another tax statute with provisions similar to section 1138(a). We find this precedent more persuasive than the inferences drawn from "dicta" by the Division.

Third, we reject the Division's assertion that because the statistical sampling methodology uses all of petitioner's books and records as the population for drawing the "random sample" to make its estimate of petitioner's tax liability, it fits the principles of Chartair (Division's brief on exception, p. 19). The Division misreads Chartair. The point in Chartair is that if books and "records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the [Division] become arbitrary and capricious and lack a rational basis (see, *Matter of Babylon Milk & Cream Co. v. Bragalini, supra*)" (*Matter of Chartair, Inc. v. State Tax Commn., supra*, 411 NYS2d 41, 43, emphasis added). Here, it is agreed by both parties that petitioner had full and complete records which were available to the Division for the conduct of an "unabridged audit" (cf., *Matter of Continental Arms Corp. v. State Tax Commn.*, 72 NY2d 976, 534 NYS2d 362, revg 130 AD2d 929, 516 NYS2d 338 [where the taxpayer refused to make its records available]). Accordingly, an estimation of petitioner's tax by the Division was not consistent with Chartair.

Fourth, the Division's own regulations follow Chartair and limit the Division's authority to estimate tax to situations where the taxpayer's records are incomplete. Specifically, these regulations provide that:

"[i]f the records of a taxpayer [required to be kept (20 NYCRR 533.2 et seq.) and presented to the Division on audit (20 NYCRR

533.2[a][2]]) are determined to be incorrect or insufficient, the return filed on the basis of information obtained from such records may be deemed to be incorrect or insufficient. The Department of Taxation and Finance may then determine the amount of tax due the State by using any information available, whether at the taxpayer's place of business or from any other source" (20 NYCRR 533.2[g][1], emphasis added).

These regulations follow the logic of section 1138(a)(1) and refute the Division's assertion that the absence of an "express restriction" in section 1138(a)(1) allows the Division to estimate taxes even when there are adequate books and records (Division's exception, pp. 15-16).

Fifth, we reject the Division's assertion that it did not need petitioner's consent to use statistical sampling to estimate petitioner's tax liability. This position flies in the face of direct precedent on the subject (see, Names in the News v. New York State Tax Commn., supra; Matter of Hard Face Welding & Mach. Co. v. State Tax Commn., 81 AD2d 967, 439 NYS2d 744; and Matter of Kennedy & Co. v. Chu, supra). Each of these decisions relies on Chartair, which we have already indicated binds this Tribunal. Further, whatever the scientific underpinning of the methodology, the Division agrees with petitioner that the statistical sampling method used is an estimate, i.e., it "allows the Division to predict that there is a 95% probability that the amount of the tax determined on audit is less than the amount actually due and a 5% probability that the amount of tax determined on audit is more than the amount actually due" (Determination,

p. 15).¹⁷ We see no practical difference between this estimating method and the "test period" audit for which the Division concedes it needs the taxpayer's consent because it is an estimate.

Finally, we address the arguments made by the Division as to the practical necessity of this computer assisted statistical sampling methodology to allow the Division to conduct audits of "large vendors." The Division's argument is rooted in the advancements in computer technology, which have occurred since the 1965 enactment of section 1138 and the 1978 decision in Chartair. The use of this technology, the Division argues, is necessary for the Division to audit large vendors on a more efficient, more complete and more cost effective basis than possible using other alternatives such as "block audits," which involve the use of a team of auditors for a specific time, and "limited scope audits," which concentrate on specific areas to audit.

We would point out that in Chartair, the Division raised a similar point when it justified its estimating the taxpayer's tax on the grounds that a complete audit "would have been very time consuming, it would have been burdensome on the taxpayer, [and] it would have been a costly venture on the [Division] as well as the taxpayer" (Matter of Chartair, Inc. v. State Tax Commn., supra, 411 NYS2d 41, 42). The court rejected this position, stating:

"[t]he honest and conscientious taxpayer who maintains comprehensive records as required [by law] has a right to expect

¹⁷The parties stipulated to the following facts:

"[t]he . . . Division determined taxes claimed to be due in this matter at the 95% confidence level, with a one-sided test, and assessing at the lower end. In statistics, 'confidence' describes a degree of certainty that an amount determined from analysis of a random sample plus or minus the 'precision' would actually include the 'true' result. When the 'confidence level' is 90%, 90 samples out of 100 samples of the same size from the same 'universe' would include within the 'precision' range the 'true' result which would be obtained if all items in the 'universe' were examined and the examination was free of transcription inaccuracies or other human error. A two-sided confidence level for a result indicates that result value with a range plus or minus the 'precision' amount. A 90 percent two-sided confidence is equivalent to a 95 percent one-sided confidence. A 95 percent one-sided confidence at the lower limit of the precision range indicates that the true result may be higher than the result from a given sample for 95 percent of samples of the same size and may be lower for 5 percent of samples of the same size" (Stipulation ¶ 11[F][15]).

that they will be used in any audit to determine his ultimate tax liability" (Matter of Chartair, Inc. v. State Tax Commn., supra, 411 NYS2d 41, 43).

In our view, the Legislature must determine whether the administrative needs of the State to insure compliance by taxpayers with the sales tax law warrants changing the rights of taxpayers under current law as expressed by the court in Chartair, its progeny and this Tribunal.

We deal next with petitioner's exception.¹⁸

The Administrative Law Judge, based on our decision in Matter of A & J Parking Corp. (supra), rejected petitioner's assertion that the failure of the Division to include a statement that the amount of the tax here was estimated did not invalidate the notice of determination. The Administrative Law Judge determined that there was no evidence that petitioner was actually prejudiced from the omission since "the failure to indicate that the tax was estimated was remedied by the constant communication between the Division and petitioner during the course of the audit" (Determination, p. 31). We affirm for the reasons stated by the Administrative Law Judge in her determination.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Marine Midland Bank, N.A. is denied;
2. The exception of the Division of Taxation is denied;
3. The determination of the Administrative Law Judge is affirmed;
4. The petition of Marine Midland Bank, N.A. is granted to the extent indicated in conclusions of law "E," "F," "G" and "I" of the Administrative Law Judge's determination, but is otherwise denied; and

¹⁸Petitioner did not take exception to that portion of the determination of the Administrative Law Judge which sustained the imposition of penalty.

5. The Division of Taxation is directed to modify the Notice of Determination dated February 24, 1988 and to issue a refund in accordance with paragraph "4" but such Notice is otherwise sustained.

DATED: Troy, New York
May 13, 1993

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner

APPENDIX A

AUDIT DATA STIPULATED ADJUSTMENTS AND THE CREDIT TRANSACTION ERROR

I. AUDIT DATA¹⁹

A. ASSETS

	UNIVERSE		SAMPLE		DIFFERENCES		POINT ESTIMATE OF DIFFERENCES
	Size	\$ Value	Size	\$ Value	Size	\$ Value	
TOTAL POSITIVE	10,847	92,291,469	2,879	77,410,940	183	226,004.90	\$280,622.79
CREDIT TRANS	<u>203</u>	<u>- 2,051,626</u>	<u>203</u>	<u>2,051,626</u>	<u>-0-</u>	<u>.00</u>	<u>-0-</u>
TOTAL	11,050	90,239,843	3,082	75,359,313	183	226,004.90	280,622.79
					less precision		<u>- 14,035.52</u>
					tax due		\$266,587.27

B. EXPENSES

	UNIVERSE		SAMPLE		DIFFERENCES		POINT ESTIMATE OF DIFFERENCES
	Size	\$ Value	Size	\$ Value	Size	\$ Value	
TOTAL POSITIVE	490,779	275,340,574	3,561	89,123,700	205	203,086.45	\$801,505.91
CREDIT TRANS	<u>11,645</u>	<u>- 6,154,078</u>	<u>250</u>	<u>- 141,781</u>	<u>-0-</u>	<u>.00</u>	<u>.00</u>
TOTAL	502,424	269,186,495	3,811	88,981,918	205	203,086.45	801,505.95
					less precision		<u>-109,614.24</u>
					tax due		\$691,891.71

C. AUDIT TOTALS

	UNIVERSE SIZE	UNIVERSE VALUE	SAMPLE SIZE	SAMPLE VALUE	SAMPLE DIFFERENCES	TAX DUE ON AUDIT
ASSETS	11,050	90,239,843	3,082	75,359,313	226,004.90	266,587.27
EXPENSES	<u>502,424</u>	<u>269,186,495</u>	<u>3,811</u>	<u>88,981,918</u>	<u>203,086.45</u>	<u>691,891.71</u>
TOTAL	513,474	359,426,338	6,893	164,341,231	429,091.35	948,478.98

¹⁹Source: Ex. C: WP-G, WP-11, WP-14, WP-15
Stip: Ex. X, Ex. W

II. STIPULATED ADJUSTMENTS

A. TRANSACTIONS AGREED NONTAXABLE

			Tax Amount
B. Angell	Stip ¶ 8-A	Stip Ex C	\$ 2,100.00
DigiLink	Stip ¶ 8-C		754.88
IVB	Stip ¶ 8-D	(V #00256852) ²⁰	626.26
Brennan Bros.	Stip ¶ 8-E	Stip Ex E	<u>915.11</u>
		Group A Total	<u>4,396.25</u>

B. TRANSACTIONS AGREED TAXABLE, NOT SUBJECT TO PENALTY

N.Y. Tel. Co.	Stip ¶ 9-B	Stip Ex H	48,033.36
American Bell	Stip ¶ 9-C	Stip Ex I	<u>236.74</u>
		Group B Total	<u>48,270.10</u>

**C. TRANSACTIONS AGREED NOT SUBJECT TO PENALTY
TAXABILITY TO BE RESOLVED BY OTHER LITIGATION**

Landlord HVAC & Cardox	Stip ¶ 8-F	Stip Ex F	1,798.27
		TOTAL DIVISION AGREES NOT SUBJECT TO PENALTY	<u>54,464.62</u>

D. TRANSACTIONS AGREED TAXABLE, PENALTY AT ISSUE

Information Services, Training Materials, Videos, Booklets	Stip ¶ 9-A	Stip Ex G	\$ 74,476.91
Contractor Charges	Stip ¶ 9-D	Stip Ex J	88,067.44 ²¹
Supplier Cost of Tax	Stip ¶ 9-E	Stip Ex K	2,037.43
Erie Cty Rate Change	Stip ¶ 9-F	Stip Ex L	2,662.88
VISA Terminals	Stip ¶ 9-G	Stip Ex M	3,412.50 ¹⁸
COAX Cable Installation	Stip ¶ 9-H	Stip Ex N	10,828.67 ¹⁸
ATM Enclosures	Stip ¶ 9-I	Stip Ex O	21,066.15 ¹⁸
Bandit Barriers	Stip ¶ 9-J	Stip Ex P	6,752.50 ¹⁸
Landlord Repairs and Maint.	Stip ¶ 9-K	Stip Ex Q	<u>11,225.83</u>
		TOTAL	<u>\$220,530.31</u>
		Group A Total	4,396.25
		Group B Total	48,270.10
		Group C Total	<u>1,798.27</u>
		TOTAL STIPULATION	<u>\$274,894.93</u>

²⁰Voucher # from petitioner's account distribution records (Ex. D).

²¹Originally claimed exempt capital improvement, Total \$126,714.76.

ANALYSIS OF STIPULATED ADJUSTMENTS

Group A, Agreed Nontaxable

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{4,396.25}{429,091.35} = 1.02\% [.0102]$$

Group B, Agreed Nontaxable, Not Subject to Penalty

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{48,270.10}{429,091.35} = 11.25\% [.1125]$$

Group C, Agreed Nonpenalty, Taxability to be Decided

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{1,798.27}{429,091.35} = .42\% [.0042]$$

Group D, Agreed Taxable, Penalty at Issue

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{220,530.31}{429,091.35} = 51.39\% [.5139]$$

Contractor Charges/Capital Improvements

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{126,714.76}{429,091.35} = 29.53\% [.2953]$$

$$\frac{\text{value in audit}}{\text{Stipulation Group D}} = \frac{126,714.76}{220,530.31} = 57.46\% [.5746]$$

Unexplained Audit Exception Items

Total Sample Exception Items	429,091.35
Total Sample Exception Items	- 274,994.31
TOTAL UNEXPLAINED	\$154,097.04

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{154,097.04}{429,091.35} = 35.91\% [.3591]$$

III. ADJUSTMENT FOR CONSISTENT HUMAN ERROR ON CREDIT TRANSACTIONS

ALTERNATIVE I

Assuming all credit transactions occurred in an 8% rate locality and not any tax was shown on credit transactions which were actually taxable, the audit error on credit transactions can be corrected as shown below:

ASSETS

$$\frac{\text{Positive Sample Differences}}{\text{Positive Sample Size}} = \frac{183}{2,879} = 6.36\% \text{ [.0636 error rate]}$$

$$2,051,626 \text{ [Credit Sample Value]} \times .0636 = 130,483 \times .08 \text{ [max tax rate]} = \$10,438.67 \quad \begin{matrix} \text{Credit} \\ \text{Universe} \\ \text{Value} \end{matrix}$$

[Credit Sample Value = Credit Universe Value]

EXPENSES

$$\frac{\text{Positive Sample Differences}}{\text{Positive Sample Size}} = \frac{205}{3,561} = 5.76\% \text{ [.0576 error rate]}$$

$$141,781 \text{ [Credit Sample Value]} \times .0576 = 8,166.54 \times .08 \text{ [max tax rate]} = 653.33 \quad \begin{matrix} \text{Credit} \\ \text{Sample Error} \end{matrix}$$

$$6,154,078 \text{ [Credit Universe Value]} \times .0576 = 354,474.89 \times .08 \text{ [max tax rate]} = 28,357.99 \quad \begin{matrix} \text{Credit} \\ \text{Universe} \\ \text{Error} \end{matrix}$$

$$\begin{matrix} \text{Credit Universe Error Assets} & 10,438.67 \\ \text{Credit Universe Error Expenses} & \underline{28,357.91} \\ & \hline 38,796.58 \end{matrix} \text{ TOTAL MAXIMUM CREDITS ADJUSTMENT}$$

ALTERNATIVE II

Assuming credit transactions were distributed among local taxing jurisdictions in the same proportion as debit transactions, the overall tax rate reflected in debit transaction tax due will reflect the correct tax rate for the credit transactions:

$$\frac{\text{Positive Sample Tax}}{\text{Positive Sample Value}} \times \text{Credit Universe Value} = \text{Credit to be Allowed}$$

ASSETS

$$\frac{\$266,005}{\$77,410,940} [= .0029] \times \$2,051,626 = \$ 5,949.76$$

EXPENSES

$$\frac{\$203,086}{\$89,123,700} [= .0023] \times 6,154,078 = \$14,154.38$$

$$\text{TOTAL MAXIMUM CREDIT ADJUSTMENT} \quad \$20,104.14$$

COMPARISON OF CREDIT ADJUSTMENT AMOUNTS TO THE NOTICE OF DETERMINATION

$$\text{Magnitude of Credit Transactions} = \frac{\text{Credit Transactions Value}}{\text{Total Population Value}}$$

$$\text{Assets} \quad \frac{2,051,626}{90,239,843} = 2.27\%$$

$$\text{Expenses} \quad \frac{6,154,078}{269,186,495} = 2.29\%$$

CREDIT ADJUSTMENT % OF NOTICE OF DETERMINATION

$$\text{ALTERNATIVE I} \quad \frac{38,796.58}{948,478.98} = 4.09\%$$

$$\text{ALTERNATIVE II} \quad \frac{20,104.14}{948,478.98} = 2.12\%$$