STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition of ELAINE LANKES d/b/a ALLEN-MACK PHARMACY 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 December 1, 1975 through August 31, 1979.	DECISION

Petitioner, Elaine Lankes d/b/a Allen-Mack Pharmacy, 202 Schimwood Court, Getzville, New York 14068, 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 December 1, 1975 through August 31, 1979 (File No. 32801).

A small claims hearing was held before Arthur Johnson, Hearing Officer, at the offices of the State Tax Commission, 65 Court Street, Buffalo, New York, on December 6, 1983 at 9:15 A.M., with all briefs to be submitted by February 28, 1984. Petitioner appeared by Robert E. Nicely, Esq. The Audit Division appeared by John P. Dugan, Esq. (Deborah Dwyer, Esq., of counsel).

ISSUE

Whether the audit procedures and tests used by the Audit Division in an examination of petitioner's books and records were proper and whether the additional taxable sales determined as a result thereof were correct.

FINDINGS OF FACT

1. Petitioner, Elaine Lankes d/b/a Allen-Mack Pharmacy, operated a drug store located at 961 Payne Avenue, North Tonawanda, New York. The business was sold on August 1, 1979.

2. On April 22, 1980, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner for taxes due of $16,964.68, plus interest of $3,349.07, for a total of $20,313.75. Said notice resulted from an audit of petitioner's books and records for the period December 1, 1975 through May 31, 1979. A second notice was issued on the same date covering the period June 1, 1979 through August 1, 1979 for taxes due of $2,127.47, plus interest of $106.48, for a total of $2,233.95. This notice included the bulk sales tax of $1,680.00 due on the transfer of furniture and fixtures; however, said tax has been paid by the purchaser.

3. On audit, the Audit Division examined petitioner's purchase journal and listed all purchases by supplier for the year 1977. Purchase invoices from each supplier were analyzed to determine whether the items purchased were taxable or nontaxable when resold. If a supplier sold both taxable and non-taxable items, a taxable percentage was computed based on randomly selected invoices from 1977. The taxable percentages were applied to total purchases from those suppliers for 1977 to determine the taxable purchases. This result was combined with purchases from suppliers of solely taxable items to arrive at total taxable purchases for 1977 of $228,215.86, representing 46.2 percent of total purchases.

A markup percentage was computed for various items purchased from suppliers that sold taxable items, based on January, 1979 purchase invoices and selling prices in effect at that time. The auditor used an average markup on items where the selling price was not available. The markup percentages were applied to total purchases for 1977 by supplier to determine a gross profit of $82,519.18 and a weighted average markup of 36.2 percent.

The taxable purchases determined above were adjusted to $225,960.53 to reflect an inventory adjustment and credits and discounts. The weighted average markup was applied to the adjusted taxable purchases to arrive at taxable sales of $307,758.24. This amount was reduced to $300,064.28 to allow 2½ percent for pilferage. The audited sales tax due thereon was $21,004.50. Petitioner reported and paid sales taxes of $15,999.07 for the same period, leaving additional tax due of $5,005.43 for an error factor of 31.3 percent for 1977. The error factor was applied to sales tax reported for the entire audit period to determine a total deficiency of $17,412.15.

4. Petitioner made the following books and records available for audit: daily sales sheets, sales and purchase journals, purchase invoices, bank deposits, sales tax returns and state and federal income tax returns.

5. Petitioner did not retain cash register tapes for the period under review.

Petitioner alleged that a New York State tax auditor conducting an income tax audit in 1977 advised her that she was not required to retain the tapes.

According to the procedures employed at the store, the pharmacist on duty cashed out the registers at the end of the day. The cash register tape totals were entered on daily sales sheets and the receipts deposited in the bank by the pharmacist. The following day petitioner compared the tapes with the daily sales records for accuracy and then discarded the tapes.

6. The taxable purchases for 1977 before adjustments were $228,215.86. Taxable sales reported for the same period amounted to approximately $228,000.00.

7. Petitioner argued that the Audit Division was required to evaluate her accounting system and to find that the books and records were inadequate before it could proceed with an audit based on purchases.

8. Petitioner analyzed the Prescription Retail Book for 1977. This book, which is required to be maintained by the New York State Health Law, recorded the prescription number and retail sales price. Such sales totalled $199,313.03 for 1977. Petitioner compared the cost and selling price of all new prescriptions sold in March, 1977 and found that the gross profit was 38 percent. The gross profit computed for the year 1977 on prescriptions was $73,946.00. Petitioner's books and records reflected a gross profit of $139,374.00 from all sales for 1977. The Audit Division determined a gross profit of $81,797.71 on taxable items for 1977. Petitioner concluded that since the gross profit on taxable items and prescriptions ($155,744.00) exceeded the overall gross profit without considering any profit from sales of nontaxable over-the-counter items, e.g., aspirin and cough medicine, the audit was erroneous, and the source of error was excessive markups on taxable items.

Petitioner presumed gross sales were correct based on an income tax audit by the Audit Division for the years 1977 and 1978 which accepted the accuracy of reported gross sales. With respect to the audit in dispute herein, the Audit Division reconciled gross sales per the sales journal with the sales tax returns; however, it did not use any procedures to verify the accuracy of such sales.

9. Petitioner also argued that the audit was incorrect for the following reasons:

a) During the audit period there was approximately $18,000.00 of unsalable damaged merchandise that was not carried as inventory on the books and records and was not returned to the supplier for credit or replacement.

b) It was improper to apply markup percentages determined in 1979 to 1977 purchases.

c) No consideration was given to sidewalk sales where items were sold at less than cost and to goods donated to hospitals.

d) The pilferage allowance was insufficient.

CONCLUSIONS OF LAW

A. That the audit procedures described in Finding of Fact "3" are generally accepted procedures established by the Audit Division which are used to determine the accuracy of books and records. These procedures disclosed a significant variance with taxable sales reported so as to conclude that sales tax was not properly charged on all taxable items. Such a discrepancy established the inadequacy and unreliability of petitioner's books and records (Matter of Korba v. N.Y.S. Tax Commission, 84 A.D.2d 655).

When books and records are insufficient, "test period" and percentage markup audits are permissible (Matter of Chartair, Inc. v. State Tax Commission, 65 A.D.2d 44; Matter of Sakran v. State Tax Commission, 73 A.D.2d 989).

Moreover, petitioner did not have cash register tapes or any other verifiable record of receipts available for audit. The failure to retain such documents justifies the Audit Division's use of markup percentages to determine taxable sales (Matter of Murray's Wines and Liquors v. State Tax Commission, 78 A.D.2d 947; Matter of McClusky's Steak House, Inc. v. State Tax Commission, 80 A.D.2d 713).

Accordingly, the Audit Division's determination of additional taxable sales and sales taxes due was proper pursuant to section 1138(a) of the Tax Law.

B. That the Audit Division reasonably calculated petitioner's tax liability. When a taxpayer's recordkeeping is faulty, exactness is not required of the examiner's audit (Matter of Meyer v. State Tax Commission, 61 A.D.2d 223 The burden then rests upon the taxpayer to demonstrate by clear and convincing evidence that the method of audit or the amount of tax assessed was erroneous (Matter of Surface Line Operators Fraternal Organization v. Tully, 85 A.D.2d 858).

C. That petitioner's analysis of prescription sales (Finding of Fact "8") and the arguments set forth in Finding of Fact "9", without supporting documentation, do not meet the burden of showing error.

D. That in accordance with Finding of Fact "2", notice number S800410743C is reduced to $447.47.

E. That the petition of Elaine Lankes d/b/a Allen-Mack Pharmacy is granted to the extent indicated in Conclusion of Law "D"; that in all other respects, the notices of determination and demand for payment of sales and use taxes due issued April 22, 1980 are sustained and the petition denied.

DATED: Albany, New York
NOV 09 1984

STATE TAX COMMISSION

Roderick G.W. Chu
PRESIDENT

Francis R. Koenig
COMMISSIONER

COMMISSIONER