

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :

of :

HARRISON RADIO CORP. :

DECISION

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 March 1, 1976
through May 31, 1980. :

Petitioner, Harrison Radio Corp., 20 Smith Street, East Farmingdale, New York 11735, 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 March 1, 1976 through May 31, 1980 (File No. 34825).

A hearing was commenced before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on June 6, 1985 at 9:15 A.M. and continued to conclusion on June 27, 1985 at 10:45 A.M., with all briefs to be submitted by September 5, 1985. Petitioner appeared by Damashek & Bezozza, Esq. (Ira S. Bezozza, Esq., of counsel). The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq., of counsel).

ISSUES

I. Whether consents executed by petitioner's controller served to validly extend the statute of limitations on assessment.

II. Whether the Audit Division determined that petitioner's records were inadequate prior to resorting to the use of external indices, or in the alternative, whether petitioner agreed to the Audit Division's use of external indices.

III. Whether the four-day test period of petitioner's claimed nontaxable sales was sufficient to provide a reliable basis for a portion of the assessment at issue.

FINDINGS OF FACT

1. On May 27, 1981, the Audit Division issued to petitioner, Harrison Radio Corp., two notices of determination and demands for payment of sales and use taxes due, assessing sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1976 through May 31, 1980 in the total principal amount of \$334,565.92, plus accrued interest. Four consecutive consents to extend the period of limitations on assessment were executed as shown below.

<u>DATE CONSENT EXECUTED</u>	<u>PERSON BY WHOM EXECUTED</u>	<u>TAXABLE PERIOD COVERED</u>	<u>DATE TO WHICH PERIOD OF LIMITATIONS EXTENDED</u>
3/26/79	Martin A. Hills	3/1/76-2/28/79	6/20/80
3/17/80	Martin A. Hills, Controller	3/1/76-2/29/80	12/20/80
12/8/80	Michael Waite, Chairman	3/1/76-5/31/80	3/20/81
2/24/81	Michael Waite, Chairman	3/1/76-5/31/80	6/20/81

2. Harrison Radio Corp. was organized in 1942. On August 31, 1976, it merged into Waite Electronics, Inc. The transferee corporation thereafter changed its name to Harrison Radio Corp.

3. Petitioner is engaged in the sale of electronic communication products, on a wholesale and retail basis. Its customers include the military and government contractors, as well as amateur radio operators. During the relevant period, the number of retail locations petitioner maintained in the greater New York City metropolitan area varied from two to six. Its principal offices were situated in Farmingdale, New York.

4. (a) Petitioner was first informed of the Audit Division's intention to conduct an examination of its books and records on March 7, 1979. The examination did not actually commence until April 15, 1980, however, due to postponements

requested by petitioner. At the time, petitioner was reorganizing its operations after suffering a substantial investment loss and was in the process of moving its accounting personnel and records to the Farmingdale office.

(b) Petitioner was unable to produce complete documents for the period March 1, 1976 through August 31, 1976; specifically, the general ledger, sales journals, some entry sheets and worksheets relating to the federal corporation income tax return were unavailable.

(c) Each of petitioner's retail stores maintained cash register tapes which they forwarded to the Farmingdale office on a weekly basis, in order for the transactions recorded thereon to be consolidated for sales tax purposes. The register tapes were coded to indicate, among other things, sales, charges, payments on account and sales tax collected. Petitioner's personnel used these various codes to prepare register reports and register take-off sheets ("RTOs").

(d) Underreported sales. The examiner reconciled petitioner's sales per its general ledger with sales per its federal corporation income tax returns. Over a three-year interval, sales as reflected in the general ledger exceeded sales reported on the federal returns by \$30,956.83, a difference of less than one-tenth of one percent. He was unable to reconcile sales per the general ledger with sales reported for purposes of Articles 28 and 29: sales as reflected in the general ledger exceeded reported sales by \$7,668,076.00. Of the total discrepancy, \$990,996.00 represented taxable sales and were assessed as such.

(e) The amount of sales tax petitioner remitted with its returns was not in agreement with the amounts shown in the sales tax payable account. The source of the postings to the sales tax payable account was the RTOs, and sales

per the general ledger exceeded sales per the RTOs. In the auditor's opinion, this differential tended to cast doubt on the accuracy of the RTOs.

(f) Nontaxable sales. Petitioner's claimed nontaxable sales fell into three categories, industrial sales, international sales and a portion of its retail sales. By random sampling techniques, the examiner verified the nontaxable nature of petitioner's industrial and international sales. With regard to retail sales, the examiner decided to conduct test period analyses, in consultation with petitioner's controller, for the following reasons:

"Vendor had an inordinate number of retail sales, and since vendor's methods and policies in regard to handling retail sales remained consistent over the years, a reasonable test was selected which would be most expedient, accurate and representative."

The examiner advised the controller that he could participate in the selection of the test periods, but not that he could reject the employment of testing procedures and insist on an item-by-item audit. As above-stated, records for March 1, 1976 through August 31, 1976 were missing; the examiner did not attempt to ascertain the availability of register tapes, register reports and RTOs for the remainder of the audit period. At the time of the tests, petitioner operated four retail stores, located in Farmingdale, Carle Place, Valley Stream and New York City. The examiner analyzed the sales of each of the stores for a two-day test period (Farmingdale, Carle Place and New York City, June 11 and June 13; and Valley Stream, June 12 and 13), selecting the dates in consideration of the availability of tapes, invoices and register reports. He transcribed nontaxable sales directly from the register tapes. He was unable, even with the assistance of petitioner's controller, to decipher some of the codes but concluded that this inability would not have a significant impact on the results of the tests. Petitioner did not furnish its customers with sales invoices for sales totalling less than \$10.00 but gave them instead a portion

of the cash register tape. According to the examiner's report, this practice rendered it impossible for him to determine whether such sales were taxable or nontaxable. The tapes also displayed nontaxable sales ranging from \$1.00 to \$3.00 which petitioner was not able to substantiate to the examiner's satisfaction. Inasmuch as petitioner calculated taxable retail sales by capitalizing the sales tax collected, the examiner employed the same procedure. He capitalized sales tax to obtain taxable sales, then deducted taxable sales from gross sales to arrive at nontaxable sales. As a result of the test period procedures, the examiner arrived at a disallowance percentage of 39.14 which he applied to claimed nontaxable retail sales; his arithmetical steps are shown below.

Retail sales per general ledger 9/1/76-5/31/80	\$17,855,900
Less: sales for resale	(565,000)
Less: amount previously assessed	(990,996)
Less: reported taxable sales	<u>(10,261,440)</u>
Nontaxable retail sales	\$ 6,038,464
Disallowance percentage	<u>.3914</u>
Disallowed nontaxable retail sales	\$ 2,363,454.80

(g) Margin of error. The examiner calculated a margin of error for disallowed nontaxable sales of .0825186 (disallowed nontaxable sales September 1, 1976 through May 31, 1980 \$2,363,454.80/reported nontaxable sales September 1, 1976 through May 31, 1980 \$28,641,469.00) and a margin of error for underreported sales of .025473571 (variance in sales, general ledger versus sales tax returns September 1, 1976 through May 31, 1980 \$990,996/gross sales per sales tax returns September 1, 1976 through May 31, 1980 \$38,902,909.00). The application of such rates resulted in disallowed nontaxable sales of \$2,542,228.65 and underreported nontaxable sales of \$1,073,089.78 for the entire period under review.

(h) Expense purchases. The examiner perused petitioner's expense purchases to determine which accounts might embrace items subject to taxation,

then tested these accounts for one-month periods to ascertain the percentages of purchases therein properly taxable.

<u>ACCOUNT</u>	<u>PERCENTAGE OF PURCHASES SUBJECT TO TAX</u>
Maintenance and repairs (72020)	9.00
Maintenance and repairs (73020)	15.86
Printed forms	32.28
Stationery	7.85
Dues and subscriptions	21.04
Catalog	100.00

Invoices for catalog purchases throughout the audit period were missing. With respect to the remainder of the above-mentioned purchases categories, invoices for the first two quarterly periods, March 1, 1976 through May 31, 1976 and June 1, 1976 through August 31, 1976, were missing; for the period September 1, 1976 through May 31, 1980, approximately five of one hundred invoices were missing. Prior to June 1, 1978, all petitioner's expense purchases were contained in one account. According to the audit report, "Vendor did have a computer run on expenses; however, it would have taken weeks to perform the tasks necessary to arrive at specific account amounts." The examiner therefore compared petitioner's expense accounts for 1979 to expenses reported on its federal return for such year, ascertained the percentage of total expenses each account represented, and multiplied total expense deductions listed on the 1977 and 1978 federal returns by the percentages so determined. The appropriate assessment rate for each account (shown in the table above) was applied, resulting in a use tax liability of \$15,201.80 for the period June 1, 1976 through May 31, 1980. For the quarters when records were missing, the examiner projected petitioner's use tax liability via a margin of error. He determined the proportion which use tax due for the period June 1, 1976 through May 31, 1980 bore to gross sales for the same period and multiplied gross sales for the

quarter ended May 31, 1976 by that percentage. In sum, use tax on expenses totalled \$15,797.26.

(i) Fixed assets. Petitioner's fixed asset purchases fell within the following categories:

Building improvements
Furniture and fixtures
Leasehold improvements*
Machinery and equipment
Delivery equipment

* Accounts for out-of-state locations were not analyzed or assessed.

Some invoices were available regarding the leasehold improvements and the furniture and fixtures accounts; with regard to the remaining accounts, invoices were unavailable. The examiner assessed the accounts in the amounts displayed below, by reason of tax being owed or missing documentation:

<u>ACCOUNT</u>	<u>AMOUNT SUBJECT TO TAX</u>
Furniture and fixtures	\$289,686.40
Leasehold improvements	337,300.61
Machinery and equipment	163,636.33
Delivery equipment	31,249.58
Amount subject to tax	<u>\$821,872.92</u>
Use tax due	\$ 57,531.04

Again, due to the unavailability of information respecting the first two quarters under audit, the examiner employed a projection to determine use tax upon fixed asset purchases.

Use tax 9/1/76-5/31/80	\$57,531.04	x gross sales 3/1/76-8/31/76	= \$4,765.74
Gross sales 9/1/76-5/31/80	\$38,902,909		
		\$3,222,704	Use tax
			3/1/76-8/31/76

(j) The results of the examination are summarized below.

Sales tax on additional taxable sales and disallowed nontaxable sales	\$233,467.00
Use tax on expense purchases	16,364.88
Use tax on fixed assets	<u>44,603.23</u>
	\$294,435.11

(k) On March 24, 1981, the audit adjustment was augmented to include retail sales per the general ledger for March 1, 1980 through May 31, 1980.

The amounts of sales and use tax assessed, therefore, were as follows:

Sales tax on additional taxable sales and disallowed nontaxable sales	\$256,471.88
Use tax on expense purchases	15,797.26
Use tax on fixed assets	<u>62,296.78</u>
	\$334,565.92

5. Subsequent to the issuance of the assessment, a pre-hearing conference was held pursuant to the Rules of Practice and Procedure (20 NYCRR 601.4[b] and [c]). By agreement of the parties, the examiner conducted a second test of claimed nontaxable retail sales, utilizing records of transactions in June, 1978. The test revealed a disallowance percentage of 10.9, as contrasted with the percentage for 1979 of 21.3. (Sometime during the district office conference or the Tax Appeals Bureau conference, the original disallowance percentage of 39.14 percent was reduced to 21.3 percent.) Given the variance between the two percentages, the examiner and petitioner's controller considered, but decided not to conduct, further testing. The examiner applied the average of the two percentages, 16.23, against claimed nontaxable sales for the audit period, with the result that this aspect of the assessment, sales tax upon disallowed nontaxable sales, was reduced from \$180,351.03 to \$84,209.64. At the conference, petitioner also presented a properly completed exemption certificate which further served to decrease the sales tax on disallowed nontaxable sales to \$76,857.57. Certain adjustments were made to underreported taxable sales, based on a reconciliation of retail sales per petitioner's general ledger with sales reported on petitioner's sales and use tax returns. This portion of the assessment, sales tax on additional taxable sales, was accordingly reduced to \$1,768.63. The use tax assessed on petitioner's fixed asset purchases was

reduced from \$11,339.06 to \$8,676.17, to eliminate the tax upon leasehold improvements. Petitioner by its authorized representative agreed to the use tax on fixed assets as so adjusted. Finally, the use tax on expenses for catalogs was decreased from \$11,326.00 to \$1,732.98. The examiner had originally disallowed and assessed all such expenses. He recalculated this portion of the assessment, considering a certain percentage of catalogs to have been shipped outside New York. Such percentage was determined from a purchase invoice furnished by petitioner and a survey listing amateur operators throughout the United States by the state in which they resided.

6. Petitioner maintains that certain sales which occurred within the test period should not have been subjected to sales tax by the examiner and thus should not have entered into the computation of the disallowance percentage. These sales were: (a) the sale on June 13, 1979 of communication equipment to Ecuatoriana Airlines ("Ecuatoriana"); (b) a sale to Angela Nocera, an employee of petitioner; (c) a lay-away sale; and (d) sales of periodicals.

7. On June 13, 1979, at the Madison Avenue, New York City retail store, petitioner sold an air-to-ground communications system to Ecuatoriana for the airline's use at its commercial facilities in Quito, Ecuador. The sales invoice, in the amount of \$454.15, listed the airline's address as Robles 840 y Amazonas, Quito. Delivery of the equipment and payment therefor took place at Ecuatoriana's terminal at the John F. Kennedy International Airport in New York City.

8. It was and is petitioner's policy to discourage sales to employees, but whenever such a sale is transacted, the appropriate sales tax is charged and collected. On June 14, 1978, Angela Nocera, an executive secretary, purchased merchandise in the amount of \$124.00 at the Farmingdale retail store.

Due to a mistake on the part of the sales clerk, sales tax was not charged on this sale. The examiner's analysis disclosed no other instance where tax was not collected upon an employee sale.

9. In general, petitioner requires a substantial deposit in order for equipment to be set aside for a particular customer. On June 13, 1979, at the Carle Place retail store, a customer tendered a check for \$1,091.40 as a deposit on merchandise. The deposit was rung up on the cash register and no sales tax was charged. The customer returned later the same day, paid the remaining \$200.00 in cash and purchased an additional item for \$10.00. The customer was charged and paid sales tax in the sum of \$70.70 on the total sale.

10. Each year, petitioner purchased several hundred thousand dollars worth of magazines, including QST, Ham Radio and Ham Radio Horizons. The selling prices ranged from \$1.25 to \$3.00. Upon the sale of a magazine to a customer, the amount was rung up on the cash register and designated on the tape by the letter "M". As above-described, since the sale was in an amount less than \$10.00, the customer was not furnished with an invoice, but a segment of the register tape. In the test period analyses, the examiner considered magazine sales totalling \$53.45 as taxable, finding petitioner's documentation insufficient to substantiate the nontaxable nature of the sales. Petitioner introduced at the hearing an analysis of its magazine purchases for the period October, 1978 through April, 1979, compiled by its independent certified public accountant.

11. Petitioner challenges the validity of the consents extending the period of limitations on assessment and the oral agreement to test period procedures. Two of the consents were executed by Martin A. Hills, petitioner's controller; petitioner asserts that Mr. Hills was not a corporate officer, nor did he possess a power of attorney authorizing him to so act on behalf of the

corporation. Petitioner also asserts that the controller acted beyond his scope of authority in orally agreeing to the use of test period methods.

12. Martin A. Hills signed petitioner's federal corporation income tax return and New York franchise tax report for the fiscal year ended May 31, 1978 on February 26, 1979, stating his title as "vice president-controller."

CONCLUSIONS OF LAW

A. That Tax Law section 1147(c) provides that where a taxpayer consents in writing to the extension of the period of limitations for assessment before the expiration of such period, any additional tax found to be due may be assessed within the extended period. "The period so extended may be further extended by subsequent consents in writing made before the expiration of the extended period." (Id.) In the matter at hand, petitioner delegated its controller to assist with and participate in the examination conducted. Thus, within the apparent scope of his duties, he executed consents extending the period of limitations on assessment. Under such circumstances, the Audit Division justifiably presumed that he was so authorized to act. (See 15 N.Y. Jur.2d Business Relationships §912 [1981].) Petitioner may not now disavow particular actions undertaken by the controller in the course of the audit. The consents are accordingly valid, and the assessment issued in a timely fashion.

B. That petitioner's contention that the Audit Division failed to ascertain the inadequacy of its record keeping prior to employing test period procedures is simply unsupported by the record. For the period March 1, 1976 through August 31, 1976, records were essentially unavailable; the examiner was unable to reconcile sales per petitioner's general ledger with sales reported for purposes of Articles 28 and 29; he was also unable to reconcile sales tax

remitted by petitioner with the sales tax payable account (the source of the latter being the RTOs); and according to petitioner's business practices, sales invoices were not maintained for sales under \$10.00. Given these deficiencies in petitioner's record keeping, the Audit Division was warranted in its resort to external indices and had no obligation to seek petitioner's approval for such audit methodology (section 1138[a][1]).


C. That petitioner has satisfactorily shown by documentary and testimonial evidence that the following sales within the test period were incorrectly disallowed by the examiner and should thus be excluded from the computation of the disallowance percentage: the sale to Angela Nocera, one of petitioner's employees; the lay-away sale; and sales of magazines. The sale to Ecuatoriana Airlines, on the other hand, is properly includible in the test; the point of delivery of the merchandise, John F. Kennedy International Airport, determines the incident of the tax (20 NYCRR 525.2[a][3]).

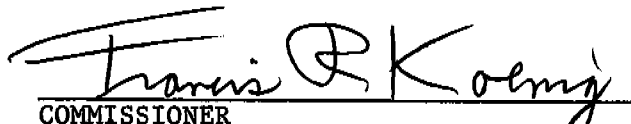
D. That the petition of Harrison Radio Corp. is granted to the extent indicated in Conclusion of Law "C"; the assessment issued on May 27, 1981 is to be reduced in accordance therewith and also to take account of the adjustments which were made at the pre-hearing conference; and except as so modified, the assessment is in all other respects sustained.


DATED: Albany, New York

STATE TAX COMMISSION

JAN 28 1986


PRESIDENT


COMMISSIONER


COMMISSIONER