

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter	of the Petition	:	
	of	:	
S.H.B. SUPER	MARKETS, INC.	:	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 September 1, 1978		:	
through August 31, 1982.		:	

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Petitioner, S.H.B. Super Markets, Inc., 434 86th Street, Brooklyn, New York 11209, 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 September 1, 1978 through August 31, 1982 (File Nos. 42842 and 43352).

A hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on August 7, 1985 at 9:15 A.M., with all briefs to be submitted by November 26, 1985. Petitioner appeared by Abraham Werfel, Esq. The Audit Division appeared by John P. Dugan, Esq. (Kevin A. Cahill, Esq., of counsel).

#### ISSUE

Whether the Audit Division's resort to test period and markup auditing procedures in determining the tax liability of S.H.B. Super Markets, Inc. was proper and, if so, whether petitioner has substantiated any items warranting reduction or cancellation of the resultant tax deficiency and/or penalties assessed in connection therewith.

FINDINGS OF FACT

1. On December 20, 1982, following a field audit, the Audit Division issued to petitioner, S.H.B. Super Markets, Inc. ("S.H.B."), the following two notices of determination and demand for payment of sales and use taxes due:

a) Notice number S821220449K, spanning the period September 1, 1978 through February 28, 1982 and assessing tax due in the amount of \$104,728.71, plus penalty and interest;

b) Notice number S821220450K, spanning the period March 1, 1982 through August 31, 1982 and assessing tax due in the amount of \$16,276.52, plus penalty and interest.

2. Petitioner, by its president, Herbert Birnbaum, had previously executed validated consents, the latest of which allowed assessments for the period September 1, 1978 through August 31, 1979 to be made on or before December 20, 1982.

3. On March 20, 1983, the Audit Division issued to S.H.B. a Notice of Determination and Demand for Payment of Sales and Use Taxes Due (Notice No. S830320107K) spanning the period December 1, 1979 through August 31, 1982 and assessing tax due in the amount of \$6,939.27, plus penalty and interest. This notice represents a supplemental assessment, issued to include additional tax claimed as due but erroneously omitted from the previously mentioned assessments due to a mathematical error in computing the amounts of tax due reflected on such prior notices.

4. S.H.B. operates a large supermarket located at 434 86th Street, Brooklyn, New York. S.H.B. has approximately 90 employees and, per its sales and use tax returns, reported gross sales of \$38,923,979.00 during the period in question. S.H.B.'s physical layout is such that it spans a city block and

has entrances and exits at the front and rear of the store. Petitioner does not employ or maintain any security personnel at its premises, believing that the presence of such personnel creates a negative customer response and atmosphere.

5. On or about August 11, 1981, the Audit Division commenced its field audit of petitioner's business. Cash and check purchases, as analyzed for the test months of September, 1980 and April, 1981, yielded the following specific and overall percentages of taxable-to-nontaxable purchases:

<u>Taxable Items Purchased</u>	<u>Percent of Purchases</u>
Soda	4.39%
Beer	2.80
Cigarettes	1.99
Pet Products	1.32
Paper Products	2.65
Misc. Taxable	<u>7.55</u>
Total	<u>20.70%</u>
Non-Taxable Items Purchased	<u>79.30%</u>

In addition, all purchases under the category "household items," a separate department at S.H.B.'s store, were treated, as conceded by S.H.B., as entirely taxable.

6. A purchase markup test was also performed, using the test months of September, 1981 and January, 1982, which yielded the following markup percentages per category of taxable item:

<u>Taxable Item</u>	<u>Markup Percentage</u>
Soda	17.72%
Beer	14.60
Cigarettes	3.19
Pet Products	35.65
Paper Products	20.78
Misc. Taxable	30.55
Housewares	89.48

7. When the aforementioned markup percentages were applied to adjusted taxable purchases, audited taxable sales of \$7,478,407.00 resulted. One-half of one percent of such audited taxable sales figure was deducted therefrom for pilferage, and the resultant figure (\$7,441,015.00), when compared to reported taxable sales per returns (\$6,263,753.00), reflected an 18.795 percent increase to reported taxable sales for the period September 1, 1978 through August 31, 1981. This same percentage increase to taxable sales was also applied to the period September 1, 1981 through August 31, 1982, based on advice by petitioner to the auditor that purchase records were not updated past August, 1981.

8. The supplemental assessment noted in Finding of Fact "3" is based on a recalculation following discovery of a mathematical error in the totalling of petitioner's purchases per disbursements, together with the application thereafter of a percentage of error increasing purchases since check purchases per actual invoices were higher than check purchases per disbursement records.

9. At the commencement of the audit, petitioner was asked to make all books and records available. Upon being informed that petitioner's cash register tapes did not identify individual items sold, the auditor deemed such tapes to be of no value for audit purposes and did not review or utilize such tapes in conducting the audit. The auditor decided to perform a test period check, utilizing a winter and a summer month as the test periods, to verify the accuracy of petitioner's sales tax returns. Petitioner objected to the use of a summer month. Conversations were held during which the auditor offered to audit all months, which offer petitioner rejected as impractical, and the auditor settled upon the months of September, 1980 and April, 1981.

10. In performing the housewares markup test, the auditor requested petitioner's most recent housewares invoices, was given a folder of invoices

and, with the exception of eighteen items, took the selling prices for such invoice items as marked on the store's shelves. Eighteen invoice items did not have shelf prices, and thus selling prices were taken from notations thereof on the invoices, as verified by petitioner's head stock clerk. Sale priced shelf items were recorded at their sale prices.

11. Housewares are rung up on two separate cash registers in the housewares department and, when the store is busy, on the regular general checkout registers.

12. The pilferage allowance (one-half of one percent of audited taxable sales) is based on standard audit guidelines. Although the auditor was asked by petitioner for a higher allowance, he refused to make any higher allowance for lack of documentation in support of higher pilferage. Pilferage, as allowed according to the auditor, encompasses theft, breakage and spoilage.

13. Petitioner operates approximately ten cash registers, manned by both full-time and part-time employees. There is a high rate of employee turnover. Daily cash register tape totals, as taken from register summary tapes on a gross total as well as a per-department total basis, are posted to worksheets daily and thereafter are entered in daily sales books. Although not completely clear in the record, it appears that petitioner's sales tax returns are computed and filed based on multiplying grocery sales per books by the percentage of sales held taxable per prior audit, with the additional sales of housewares and tobacco products added thereto as entirely taxable (reduced by an adjustment of approximately five percent of such sales to encompass tax exempt sales). An estimated taxable percentage rather than tax collected per books was used in order to comply with the results of the prior audit.

14. Petitioner does not maintain records of theft, breakage or spoilage and notes that such items would appear only as a shrinkage in inventory when

periodic inventory is taken. Petitioner asserts, however, that the layout of the store, its high volume of activity, the noted absence of security personnel and instances where other neighborhood stores have caught persons with unreceipted merchandise from petitioner's store all indicate that a higher than usual pilferage allowance (estimated at 3 percent by petitioner's representative rather than the .5 percent allowed) should be granted.

15. The auditor adjusted purchases by a factor of .000700795 (based on the two test months) to reflect the fact that check purchases (disbursements) exceeded purchases per books. The overall effect of this adjustment was to increase purchases by \$162,484.81 and, in turn, increase taxable purchases, sales and, ultimately, tax due.

16. The auditor noted a \$16,000.00 (approximate) inventory decrease and added this amount to purchases. He was advised by petitioner that inventory amounts reflected on petitioner's Federal income tax returns "might not be correct."

17. The audit herein does not question and, in fact, accepts gross sales as reported by petitioner. Rather, the result of the audit and the deficiency determined reflects an increase in the portion of such sales determined to be taxable sales.

18. The ratio of taxable to non-taxable purchases (i.e. product mix excluding housewares) as determined upon audit (see Finding of Fact "5") was nearly the same (within one percent) as petitioner's calculation of such mix.

19. The auditor recommended the assessment of penalty based on the deemed underreporting and underpayment of tax as discovered by the audit and for petitioner's failure to comply with the results of prior audits.

20. Some of the invoices in the housewares file given to the auditor were up to one year old. Petitioner asserts that the auditor's request for "the

most recent invoices" was insufficient and, when seeing any year old invoices, the auditor should have re-inquired as to whether there were any more recent invoices. Petitioner maintains there "could have been" more recent invoices at the time of the audit, although none were produced at the hearing.

21. Although houseware items were conceded to be 100 percent taxable, the auditor performed a purchase markup test rather than accepting petitioner's records regarding housewares sales because, at times, housewares were sold through registers other than those in the housewares department (i.e. not all housewares sales were made in the housewares department via cash registers exclusively used for housewares sales).

22. Petitioner maintains that the housewares markup determined on audit was too high, and notes that sales of high volume/allegedly low markup seasonal items such as Christmas trees, beach chairs and school supplies, which would reduce the overall markup percentage, were not included in the audit tests. The auditor was not made aware of such sales upon audit, nor was he given or did he see invoices pertaining to purchases of such items.

23. Petitioner notes that when the result of a prior audit indicated a higher percentage of sales as taxable than were being estimated by petitioner, petitioner increased the estimated percentage of sales reported as taxable (excluding housewares sales which were 100 percent taxable) to the percentage determined upon such prior audit.

24. Petitioner maintains that its records, specifically its daily books as established from cash register summary tape totals, were accurate and should have been used for audit purposes in general, and specifically to arrive at tax due on housewares rather than resorting to a test for housewares which are concededly 100 percent taxable. The Audit Division, by contrast, asserts that

since housewares were rung up on general registers as well as on the housewares registers and since none of the cash register tapes specified individual items, there is no assurance that housewares were always rung up as taxable items or even as housewares.

25. With regard to the purchases adjustment noted in Finding of Fact "15", petitioner maintains that the difference between check purchases (disbursements) per invoices and check purchases per disbursement records was based on inclusion of non-taxable items such as advertising, food wrapping paper and insurance (denominated non-purchases) among check disbursements per invoices, whereas disbursements per books did not include such items.

26. Purchases recorded by the auditor for one of the test months, specifically September of 1980, erroneously included two purchases dated from the preceding month of August, 1980 in the respective amounts of \$393.64 and \$543.11.

27. Petitioner does not contest the use of test period auditing techniques, but asserts that its circumstances are such that the audit procedures were inappropriate and unreasonable, that the results do not reflect the true amount of tax due and that there are errors in the audit calculations. Furthermore, petitioner seeks abatement of the penalties imposed.

28. Petitioner asserts that a prior Audit Division audit had revealed a housewares markup percentage of 40.8, which is substantially less than the 89.4 percent determined via the instant audit and that the former figure should be used.

29. The inventory adjustment noted in Finding of Fact "16" was based on the difference between January, 1979 opening inventory and December, 1980 closing inventory (\$260,700.00 v. \$276,410.00) with January, 1979 rather than



January, 1978 used by the auditor as the starting point since it is "closer" to the September, 1978 audit period starting date.

CONCLUSIONS OF LAW

A. That section 1138(a) of the Tax Law provides, in part, that if a return required to be filed is incorrect or insufficient, the Tax Commission shall determine the amount of tax due on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices.

B. That in determining the amount of a sales tax assessment, it is the duty of the Audit Division to select a method "'reasonably calculated to reflect the taxes due' (Matter of Grant Co. v. Joseph, 2 N.Y.2d 196, 206)." (Matter of Meyer v. State Tax Comm., 61 A.D.2d 223, 227 lv. to app. den. 44 N.Y.2d 645). When the Audit Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Comm., supra).

C. That petitioner did maintain books and records which were made available to the Audit Division. However, these records were insufficient for verification of taxable sales, inasmuch as the Audit Division could not determine from such records, including cash register tapes and petitioner's daily books as compiled therefrom, whether tax had been charged on all taxable items or whether the proper amount of tax had been charged in each instance. Accordingly, the Audit Division's use of a purchase analysis and markup audit to estimate the tax due from petitioner was reasonable under the circumstances (Matter of Licata v. Chu, 64 N.Y.2d 603). In fact, even petitioner utilized estimates to a certain degree rather than relying totally on its records in preparing tax returns.

D. That upon all of the facts and circumstances presented herein, including testimony by Lawrence J. Levine (who was intimately involved with petitioner's operation) that petitioner sustained substantial losses due to theft, it is found that the pilferage allowance should be increased to 1.75 percent of audited taxable sales. Furthermore, the deficiency is to be recomputed and further reduced to reflect: a) elimination of the two August purchases erroneously included in the September, 1980 test month (see Finding of Fact "26"); b) elimination of the purchase adjustment based on inventory, (see Findings of Fact "16" and "29") and, c) elimination of the purchase increase based on disbursement discrepancy (see Findings of Fact "8", "15", and "25").

E. That although asserting the existence of more recent invoices than those used by the Audit Division in determining the markup on housewares, no such invoices were produced. Nor has petitioner offered even a sampling of invoices in support of the assertion that the high volume/low markup houseware items noted in Finding of Fact "22" were sold and, in turn, the volume and/or effect of such sales on the housewares analysis. While offering the assertion that the housewares markup was too high, petitioner has produced no evidence of a more appropriate markup percentage other than the 40.8 percent figure determined by an audit conducted a number of years before the instant audit.

F. That in view of the substantial discrepancy between the amount of sales tax found due on audit, even after the adjustments made in Conclusion of Law "D", and the sales tax reported, petitioner has not supported a basis for the remission of penalty. Noted also in this context is the fact that petitioner itself relies to an extent on estimates rather than on amounts in its books and records in filing its returns.

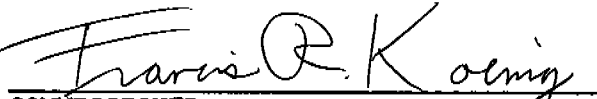
G. That the petition of S.H.B. Super Markets, Inc. is granted to the extent indicated in Conclusion of Law "D"; that the Audit Division is directed to modify the notices of determination and demand accordingly; and that, as modified, such notices are sustained.


DATED: Albany, New York

STATE TAX COMMISSION

FEB 18 1986

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER