

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of the Petition
of
PADULA'S SPIRITS OF "76", INC.
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 June 1, 1978
through February 28, 1982.

DECISION

Petitioner, Padula's Spirits of "76", Inc., 74 Pearl Street, New York, New York 10004, 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 June 1, 1978 through February 28, 1982 (File No. 43026).

A hearing was held before Doris E. Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on February 19, 1985 at 1:20 P.M. Petitioner appeared by Schwinger, Simon & Co., P.C. (Melvin Schwinger, CPA). The Audit Division appeared by John P. Dugan, Esq. (Anne W. Murphy, Esq. of counsel).

ISSUES

- I. Whether the Audit Division properly applied markup procedures to verify petitioner's sales of wine and liquor.
- II. Whether the Audit Division properly disallowed a portion of petitioner's claimed nontaxable sales as unsubstantiated.

FINDINGS OF FACT

1. On December 20, 1982, subsequent to the conduct of field examination of petitioner's books and records, the Audit Division issued to Padula's Spirits of "76", Inc. a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, assessing sales and use taxes pursuant to Tax Law Articles

28 and 29 for the period June 1, 1978 through February 28, 1982 in the amount of \$7,015.81, plus interest. Petitioner's authorized representative had executed three consecutive consents to extend the period of limitations for assessment of sales and use taxes for the taxable period June 1, 1978 through May 31, 1981 to and including December 20, 1982.

2. Petitioner operates a small retail liquor store near the financial district of New York City.

3. (a) During the course of the field audit, petitioner made available to the sales tax examiner, among other things, its cash receipts journal, purchases journal, general ledger, sales invoices and exemption certificates for claimed nontaxable sales, and purchase invoices for a one-year test period (June 1, 1980 through May 31, 1981). The sales tax examiner reviewed petitioner's bank statements for the entire audit period. Deposits totalled \$1,331,837.42, including sales tax reported and paid of \$93,240.37. Petitioner established to the examiner's satisfaction that gross and taxable sales for the quarter ended February 28, 1981 were overstated by \$18,500.00, by reason of a transfer from another account. Petitioner's gross sales according to the bank statements were thus \$1,220,097.05. Because petitioner's sales tax returns filed for the audit period did not provide figures for gross sales and because petitioner was unable to furnish any cash register tapes, the sales tax examiner resorted to the use of markup tests to verify petitioner's taxable sales.

(b) Petitioner's records did not reflect a division between wine and liquor purchases and sales. The examiner accordingly analyzed petitioner's purchase invoices for a one-year test period and ascertained that wines represented 37.44 percent of petitioner's total purchases, and liquor, 62.56 percent of purchases. On February 4, 1982, the examiner visited petitioner's retail

store and calculated a markup percentage for wine of 41.19 percent and a markup for liquor of 11.24 percent. He determined such percentages by reference to then current purchase invoices and shelf prices, the latter including some prices of wine on special discount display. The further arithmetical steps of his markup tests are shown below.

(a) LIQUOR

\$1,074,946 total purchases x 62.56% = \$672,486 liquor purchases

\$672,486	liquor purchases
x 1.1124	liquor markup
<u>\$748,073</u>	liquor sales

(b) WINE

\$1,074,946 total purchases x 37.44% = \$402,460 wine purchases

\$402,460	wine purchases
<u>1.4119</u>	wine markup
\$568,233	wine sales

(c) TOTAL SALES per markup tests

\$ 748,073	liquor sales
<u>568,233</u>	wine sales
\$1,316,306	total audited sales

He reduced the audited taxable sales by claimed nontaxable sales (\$99,025.00) and by taxable sales reported on returns filed (\$1,155,538.00), yielding additional taxable sales of \$61,744.00, upon which \$4,982.13 in sales tax was due.

(c) The examiner also analyzed petitioner's nontaxable sales for the period June 1, 1978 through May 31, 1981, such sales claimed to have been made for resale and to exempt organizations and diplomats. Petitioner presented supporting invoices and resale or exemption certificates for \$56,264.84 of the total of \$81,205.23 claimed nontaxable sales. The examiner therefore calculated an error rate of 30.71278 percent (\$24,940.39 unsubstantiated nontaxable sales/\$81,205.23 claimed nontaxable sales) and applied such rate to claimed

nontaxable sales for the audit period of \$99,025.00; the result was additional taxable sales of \$30,413.39, upon which additional sales tax of \$2,445.64 was due.

(d) Finally, the examiner reviewed petitioner's additions to fixed assets and leasehold improvements. He found use tax due in the total amount of \$81.28 on the purchases of a cash register and a floor covering.

4. Prior to the issuance of the Notice of Determination and Demand, petitioner's authorized representative met with the sales tax examiner and his supervisor to discuss the examination results. Through its representative, petitioner objected to the examiner's failure to take cognizance of breakage and pilferage. The Audit Division representatives were of the opinion that the liquor markup was sufficiently low so as to incorporate an allowance for breakage and pilferage. A one-percent reduction of petitioner's wine purchases was permitted, however, for such factors. Petitioner also maintained that retail liquor stores in the vicinity had engaged in a "price war" on wines and that for an extensive period, petitioner had sold wines at or near cost. The Audit Division consequently allowed an adjustment of \$389.42, but solely for the quarter ended February 28, 1980. The two agreed upon adjustments had the effect of decreasing the sales and use taxes per the examination from \$7,509.05 to \$7,015.81, the amount assessed.

5. Petitioner's position is that all sales receipts were deposited to its account, and that all taxable sales were reported on its returns as filed. Petitioner took strong exception to the Audit Division's markup test of wine purchases, especially the markup percentage applied (41.19 percent). In keeping with the business practices of retail liquor stores located in the vicinity, petitioner's markup of wine over its cost was very low. Such percentage

allows petitioner to remain competitive, and also serves as an inducement for customers to patronize petitioner's store and purchase liquor (on which petitioner's profit margin is higher). Petitioner advertises weekly special sales on wine (e.g., a discount of 10 percent on all wines) by posting signs in the store and in nearby commercial buildings and by distributing circulars to pedestrians. Petitioner offered in evidence several letters from customers, who purchased wine by the case during the holiday season for gift-giving to their clients; in each letter, the customer expressed appreciation to petitioner for its low markup. Petitioner offered, in addition, sales invoices for December, 1981, and "Beverage Media", a beverage industry monthly publication which compiles wholesale prices for innumerable brands of liquor and wine. A comparison of the invoices with the publication supports petitioner's position with respect to its wine markup (illustrative markups: Korbel Champagne, 4.9 percent; Bolla Soave, 5.3 percent; Martini & Rossi Asti Spumante, 5.5 percent; Bolla Valpolicella, 3.3 percent).

CONCLUSIONS OF LAW

A. That petitioner satisfactorily established that the markup percentage utilized by the Audit Division to verify petitioner's taxable sales of wine was excessive. Consequently, the portion of the assessment based upon such testing is cancelled.


B. That petitioner failed to establish any error in the remaining audit procedures: the markup test of liquor purchases, the partial disallowance of claimed nontaxable sales for lack of exemption and resale certificates, and use tax computed on purchases made; the portions of the assessment premised on these procedures must therefore be sustained.

C. That the petition of Padula's Spirits of "76", Inc. is granted to the extent indicated in Conclusion of Law "A"; the assessment issued on December 20, 1982 is to be reduced accordingly; and except as so granted, the petition is in all other respects denied.

DATED: Albany, New York

JUL 10 1985

STATE TAX COMMISSION


PRESIDENT


COMMISSIONER


COMMISSIONER