

STATE OF NEW YORK
STATE TAX COMMISSION
ALBANY, NEW YORK 12227

May 27, 1983

Nu Way Drug Center of Stony Brook, Inc.
Nu Way Drug Ctr. of Bohemia, Inc. & Nu Way Drug Ctr., Inc.
c/o Erwin Popkin
55 Mineola Blvd.
Mineola, NY 11501

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1138 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Law and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance
Law Bureau - Litigation Unit
Building #9 State Campus
Albany, New York 12227
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative
Michael Salgo
Law Office of Erwin Popkin
55 Mineola Blvd.
Mineola, NY 11501
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Nu-Way Drug Center of Stony Brook, Inc. :
for Revision of a Determination or for Refund of :
Sales & Use Taxes under Articles 28 & 29 of the Tax :
Law for the Period 3/1/75-5/31/78 :

In the Matter of the Petition :
of :
Nu-Way Drug Center of Bohemia, 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 9/1/76-2/28/78 :

AFFIDAVIT OF MAILING

In the Matter of the Petition :
of :
Nu-Way Drug Center, 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 3/1/75-2/28/78 :

State of New York
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 27th day of May, 1983, he served the within notice of Decision by certified mail upon Nu Way Drug Center of Stony Brook, Inc., Nu Way Drug Ctr. of Bohemia, Inc. & Nu Way Drug Ctr., Inc. the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Nu Way Drug Center of Stony Brook, Inc.
Nu Way Drug Ctr. of Bohemia, Inc. & Nu Way Drug Ctr., Inc.
c/o Erwin Popkin
55 Mineola Blvd.
Mineola, NY 11501

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this
27th day of May, 1983.

David Parshuck

Conni P. Heyland

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :
of :
Nu-Way Drug Center of Stony Brook, Inc. :
for Revision of a Determination or for Refund of :
Sales & Use Taxes under Articles 28 & 29 of the Tax :
Law for the Period 3/1/75-5/31/78 :

In the Matter of the Petition :
of :
Nu-Way Drug Center of Bohemia, 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 9/1/76-2/28/78 :

AFFIDAVIT OF MAILING

In the Matter of the Petition :
of :
Nu-Way Drug Center, 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 3/1/75-2/28/78 :

State of New York
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 27th day of May, 1983, he served the within notice of Decision by certified mail upon Michael Salgo the representative of the petitioners in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Michael Salgo
Law Office of Erwin Popkin
55 Mineola Blvd.
Mineola, NY 11501

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this
27th day of May, 1983.

David Parchuck

Connie R. Hayland

AUTHORIZED TO ADMINISTER
OATHS PURSUANT TO TAX LAW
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition
of
NU-WAY DRUG CENTER OF STONY BROOK, 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 March 1, 1975
through May 31, 1978.

In the Matter of the Petition
of
NU-WAY DRUG CENTER OF BOHEMIA, 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 September 1, 1976
through February 28, 1978.

In the Matter of the Petition
of
NU-WAY DRUG CENTER, 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 March 1, 1975
through February 28, 1978.

DECISION

Petitioner, Nu-Way Drug Center of Stony Brook, Inc., 2194D Nesconset Highway, Stony Brook, New York 11790, 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, 1975 through May 31, 1978; petitioner, Nu-Way Drug Center of Bohemia, Inc., 4621 Sunrise Highway, Bohemia, New York 11716, 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, 1976 through February 28, 1978; and petitioner, Nu-Way Drug Center, Inc., 1066 Route 112, Port Jefferson Station, New York 11776, 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, 1975 through February 28, 1978 (File No. 24016).

A formal 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 April 29, 1982 at 1:15 P.M. and at the offices of the State Tax Commission, State Campus, Albany, New York, on June 28, 1982 at 1:30 P.M. Petitioners appeared by Erwin Popkin, P.C. (Michael Salgo, Esq., of counsel). The Audit Division appeared by Paul B. Coburn, Esq. (Alexander Weiss, Esq., of counsel).

ISSUE

Whether the test-period procedures used in auditing petitioners' books and records were proper.

FINDINGS OF FACT

1. On June 30, 1978, the Audit Division issued to petitioner Nu-Way Drug Center of Stony Brook, Inc. ("Nu-Way Stony Brook") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, assessing taxes due under Articles 28 and 29 of the Tax Law for the period March 1, 1975 through May 31, 1978 in the amount of \$98,732.84, plus penalty of \$17,680.76 and interest of \$15,992.08, for a total due of \$132,405.68. Mr. Myron Fisher, the secretary-treasurer of Nu-Way Stony Brook, had executed a consent extending the period of limitation for assessment of tax for the period March 1, 1975 through February 28, 1978, to and including March 20, 1979.

On May 28, 1979, the Audit Division issued to petitioner Nu-Way Drug Center of Bohemia, Inc. ("Nu-Way Bohemia") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, assessing taxes due under Articles 28 and 29 of the Tax Law for the period September 1, 1976 through February 28, 1978 in the amount of \$27,668.42, plus penalty of \$6,336.65 and interest of \$5,462.49, for a total due of \$39,467.56.

On April 20, 1978, the Audit Division issued to petitioner Nu-Way Drug Center, Inc. ("Nu-Way Port Jefferson") a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, assessing taxes due under Articles 28 and 29 of the Tax Law for the period March 1, 1975 through February 28, 1978 in the amount of \$63,852.70, plus penalty of \$11,207.66 and interest of \$9,819.10, for a total due of \$84,879.46.

2. Petitioners were related corporations which operated drug stores. On February 6, 1978, the corporations were sold, along with another related corporation, to Arcade Drug Center, Inc. ("Arcade").

3. After receiving notification of the bulk sale, the Audit Division assigned Michael Lento, a sales tax examiner, to audit the records of Nu-Way Port Jefferson. Mr. Lento commenced his examination on April 5, 1978, at which time the records of the three petitioners were located in the warehouse of a liquor store owned by Mr. Fisher.

Mr. Lento had left the employ of the Audit Division by the time the formal hearing was conducted; neither party subpoenaed him to testify.

According to Mr. Lento's audit report, the general ledger for the period March 1, 1975 through February 6, 1978, the cash receipts journal and the cash disbursements journal for the period March 1, 1976 through February 6, 1978, the federal income tax return for the fiscal year ending January 31,

1977, and purchase invoices were made available to him for examination. Mr. Lento expressly noted in his report that for periods prior to March 1, 1976, daily cash reconciliation sheets and the cash receipts and disbursements books were not available. There is no notation regarding whether all or only some purchase invoices were available.

Mr. Lento analyzed Nu-Way Port Jefferson's purchase invoices for the test months May and October, 1976, to determine taxable ratios in three categories, drugs (before September 1, 1976 and after August 31, 1976), cigarettes and general merchandise, those categories according to which purchases were grouped in the store's purchase journal. The resulting taxable ratios were as follows:

- (a) drugs: prior to September 1, 1976, 1.41 percent; after August 31, 1976, 0.95 percent;
- (b) cigarettes: 100 percent;
- (c) general merchandise: prior to September 1, 1976, 75.85 percent; after August 31, 1976, 75.1 percent.

These percentages were then applied to total check purchases for the period March, 1976 through December, 1977 (excluding November and December, 1976, which were separately analyzed for the reason that purchases for these months were not properly categorized) to arrive at taxable purchases.

Mr. Lento analyzed cash purchases for the months of March and April, 1976, finding 97.34 percent thereof taxable. He applied such ratio to cash purchases for the period March, 1976 through December, 1977, which computation resulted in additional taxable purchases in the "general merchandise" category, thereby increasing the taxable ratios from 75.85 and 75.1 percent to 76.94 and 76.22 percent, respectively.

He next adjusted the taxable ratio in the "cigarettes" category to 63.45 percent, after allowance for cigarette tax.

Based upon his observations and advertising circulars presented to him by Nu-Way Port Jefferson, Mr. Lento accepted the book markups.

Finally, he applied the taxable ratios determined on purchases to gross sales, and compared audited taxable sales to reported taxable sales. Application of error rates (for the period prior to September 1, 1976 and for the period after August 31, 1976) resulted in additional taxable sales in the amount of \$887,181.60.

4. On May 19, 1978, audit of Nu-Way Stony Brook was assigned to Bernard Martin. Mr. Martin had been a sales tax examiner with the Audit Division for approximately one year, during which period he had conducted approximately 25 audits, the majority involving cash method retail stores and light industry. From May 19 through June 27, Mr. Martin made a minimum of 6 attempts, by telephone calls to Mr. Fisher and petitioners' attorneys and accountants, and by personal visit to the liquor store owned by Mr. Fisher, to obtain access to the Nu-Way Stony Brook records. On June 29, 1978, Mr. Martin drew an estimated assessment against Nu-Way Stony Brook for the period March 1, 1975 through May 31, 1978, based upon Mr. Lento's audit of Nu-Way Port Jefferson. Regarding this use of the Nu-Way Port Jefferson audit, Mr. Martin testified, "[H]ere was a related company run in a similar fashion in which an audit was performed, and it produced additional tax due. I thought to use that would be as close as I could get in the absence of books and records."

As the result of a conference attended by Mr. David Sinclair (president of each of the petitioner corporations), petitioners' attorney, Mr. Martin and Mr. Alfred Fesefeldt (Mr. Martin's supervisor), Nu-Way Stony Brook agreed to

make records available for audit. The records were situated, as above-mentioned, in the warehouse of a liquor store owned by Mr. Fisher.

On August 18, 1978, Mr. Martin visited the warehouse to commence his examination and transcription of Nu-Way Stony Brook's records; he made 2 additional visits thereafter, on August 21 and August 28, spending a total of 10½ hours at the warehouse.

According to Mr. Martin's testimony, Nu-Way Stony Brook's records, consisting of thousands of pages, were contained in cartons, but were not ordered sequentially or in any other manner. He initially requested the worksheets from which Nu-Way Stony Brook's sales tax returns had been prepared, but these were not made available. A checklist prepared by Mr. Martin and submitted with his audit report indicated the following records were available for examination: sales tax returns, federal and state income tax returns, cash receipts journal, purchases journal, purchase invoices (for the test period, discussed infra) and the general ledger; not available, according to the checklist, were: sales invoices (for the test period) and statements of closing inventory.

Nu-Way Stony Brook's cash registers were computerized, and the daily tapes turned over to petitioners' bookkeeper for recording. Mr. Martin testified that "sales records verifying sales tax collected" were unavailable, and further that he did not directly receive any assistance from Mr. Fisher or anyone else connected with Nu-Way Stony Brook in ordering the records.

By comparing Nu-Way Stony Brook's federal income tax return, New York sales and use tax returns, and books for the fiscal year ended November 30, 1976, Mr. Martin discovered the following discrepancies: a difference between sales per records and gross sales reported on Nu-Way Stony Brook's federal

return in the amount of \$10,219.56 (1.12 percent); a difference between purchases per books and purchases reflected on the federal return of \$4,906.00 (0.62 percent); and a difference in sales per books and gross sales reported on the sales tax returns of \$2,648.44 (0.29 percent).

Mr. Martin attempted to verify Nu-Way Stony Brook's book figures for purchases during a quarterly period by comparison with the purchase invoices for the same quarter, but was unable to "tie into a total quarter". He therefore analyzed check purchases made in July, 1977, which in his opinion was a month representative of Nu-Way Stony Brook's business. Furthermore, Mr. Martin stated that purchase invoices for approximately 18 of the 36 months under examination were available, but that July, 1977 was the only month he could tie into a book figure. Many purchase invoices were still unpaid, and others were not reflected in the purchases journal.

Mr. Martin categorized Nu-Way Stony Brook's purchases for the test month and calculated the ratio of purchases in each category to total purchases, as follows:

Nontaxable	20.65%
Sundry	19.62%
Cards	.6799%
Cosmetics	1.752%
Candy	2.961%
Soda	1.744%
Photo	6.286%
Cigars and tobacco	1.594%
Cigarettes	44.706%

He then applied markups to the various categories, said markups (except with regard to cigarettes the markup of which was obtained from the records of another related entity) taken from an inventory report, as of January 31, 1978, of Nu-Way Port Jefferson prepared by Ace Inventory Corp. ("Ace"). Actual selling prices could not be ascertained because by the time of the audit, the

stores had been sold to Arcade. Mr. Martin checked the markups against his office's experience and accepted them as falling within a reasonable range.

Mr. Fisher informed Mr. Martin that the inventory had been taken on a related store engaged in a similar business. Mr. Martin did not know whether the Nu-Way Stony Brook and Nu-Way Port Jefferson stores were of similar size, whether they sold merchandise in comparable proportions and at similar prices, or who engaged Ace to conduct the inventory.

Mr. Martin increased check purchases by underposted purchases to arrive at audited check purchases of \$2,051,300.49, and subsequently reduced that figure by an inventory adjustment to arrive at audited cost of goods sold in the amount of \$1,975,451.49.

Mr. Martin determined the amount of purchases in each of the above-mentioned categories by applying the appropriate ratio to audited cost of goods sold; he then marked up the categorized purchases.

Of \$21,906.47 in cash purchases, \$17,565.90 were computed to be of taxable items (soda) and were marked up \$4,215.82 to arrive at audited taxable soda sales (cash purchases) of \$21,781.72.

Mr. Martin found total audited taxable sales of \$1,628,919.62, which he adjusted for cigarette tax to \$1,427,718.11.

From time to time during the audit, Mr. Fesefeldt was present to supervise Mr. Martin's work. Mr. Martin also met with Mr. Fisher and on one occasion, Mr. Sinclair.

In accordance with the results of the audit, the assessment issued against Nu-Way Stony Brook was adjusted on May 24, 1979 to a revised amount of tax due of \$49,875.92.

5. Subsequent to the issuance of an estimated assessment based upon the bulk sale questionnaire filed by the purchaser of Nu-Way Bohemia, on October 6, 1978, Mr. Martin was assigned to conduct an audit of the third petitioner herein. He found gross sales per Nu-Way Bohemia's books in agreement with those reported on the sales tax returns.

Mr. Martin again found voluminous records and encountered the same problem he had with Nu-Way Stony Brook: reconciling check purchases per the books with invoices available.

Consequently, Mr. Martin analyzed check purchases made for the month of April, 1977, which were categorized by the vendor into department 1, prescription drugs; department 2, cigarettes; and department 3, other. He verified all postings to department 1 during the test month as nontaxable drugs and all postings to department 2 as cigarette purchases. He sub-categorized purchases to department 3 and calculated the ratio of each subcategory to total purchases in department 3, as follows:

Nontaxable	10.48%
Sundry	65.03%
Cards	7.52%
Cosmetics	2.47%
Candy	7.44%
Soda	3.21%
Photo	3.80%

Because cash purchase invoices were not available for testing, Mr. Martin utilized the percentage of cash purchases found taxable upon audit of Nu-Way Port Jefferson (97.34 percent). He applied this percentage to cash purchases, resulting in \$7,076.17 of taxable items (soda), which he then marked up to arrive at audited taxable soda sales (cash purchases) of \$8,774.48.

With regard to department 2, Mr. Martin marked up purchases of \$246,793.91 to arrive at audited cigarette sales of \$263,427.81. He adjusted such audited

sales to take cognizance of cigarette tax and finally, computed taxable cigarette sales in the amount of \$173,224.64.

Mr. Martin increased check purchases of \$261,248.50 in department 3 by underfooted purchases to arrive at audited check purchases of \$307,850.00.

He made no determination as to cost of goods sold, due to unavailability of opening and closing inventory.

Markups taken from the Ace report were applied to the various subcategories of department 3 (excluding, of course, the nontaxable items).

Audited taxable sales for Nu-Way Bohemia totalled \$601,984.11.

6. Petitioners offered the testimony of their bookkeeper with regard to petitioners' manner of record-keeping and maintenance of records. On a daily basis, register tapes, reflecting sales made by department (drugs, cigarettes or general merchandise), were sent to the main office for posting to the cash receipts book. Similarly, bills for the stores were computerized and forwarded to the main office for posting to the purchases journal. The receipts and purchases journals were subsequently used in making entries to the general ledger maintained for each store. Petitioners' accountants reviewed the books and records on a monthly basis.

According to the bookkeeper, none of the above-mentioned records were ever discarded. Upon the sale of the three stores, the file cabinets and portable files containing all the records were relocated, under the bookkeeper's supervision, to the warehouse behind Mr. Fisher's liquor store.

7. When Mr. Martin and Mr. Lento were conducting their respective audits, the bookkeeper was present, pursuant to Mr. Sinclair's request, to "work with them". She testified that whenever either of the examiners requested documents, she gathered them from the files.

8. Petitioners' accountant noted an error made in the Nu-Way Stony Brook audit which when taken into account, had the effect of reducing the assessment by \$1,915.32; the Audit Division agreed to this reduction.

9. It is petitioners' position that all records kept in the conduct of their business, including cash register receipts, were available for examination by the Audit Division; this position finds support in the testimony of their bookkeeper. On the other hand, it is the Audit Division's position that there were no records from which its examiners could verify taxable sales receipts and sales tax collected; this position is supported by Mr. Martin's testimony.

10. Petitioners did not offer in evidence any receipts, invoices, journals or ledgers nor any documents which would demonstrate that their sales and use tax returns were correct as filed.

CONCLUSIONS OF LAW

A. That where a sales and use tax return when filed is incorrect or insufficient, the amount of tax shall be determined by the Audit Division from such information as may be available; if necessary, the tax may be estimated on the basis of external indices. Tax Law section 1138(a)(1). Reliance by the Audit Division upon estimation procedures is warranted only where the taxpayer's record-keeping is so insufficient as to make it "virtually impossible to verify taxable sales receipts and conduct a complete audit." (Emphasis added.) Matter of Chartair, Inc. v. State Tax Comm., 65 A.D.2d 44, 46 (3d Dept.).

B. That petitioners have proved that at the time of the Audit Division's examination of their records and its employment of test-period techniques, their records (including cash register receipts) were in existence. They have failed to prove, however, that these records revealed which sales were treated as taxable when made. It was thus impossible for the Audit Division to verify

taxable sales receipts, most particularly in the "general merchandise" category; and the examiners' use of a test period cannot be said to have been unreasonable. Matter of Korba v. N.Y.S. Tax Comm., 84 A.D.2d 655 (3d Dept.), mot. for lv. to app. den., 56 N.Y.2d 502. Cf. Matter of Allied New York Services, Inc. v. Tully, 83 A.D.2d 727 (3d Dept.).

Finally, petitioners have not shown the auditing procedures to be erroneous or incorrect in any other respect (e.g., that the markup percentages were unreasonable or the test months unrepresentative).

C. That there has been no gross negligence or willful intent to disobey the Tax Law on petitioners' part; therefore, all penalties in excess of that amount of interest prescribed by statute are remitted. 20 NYCRR 536.1.

D. That the petition of Nu-Way Drug Center of Stony Brook, Inc. is granted to the extent indicated in Conclusion of Law "C", and the notice of determination issued on June 30, 1978 (as revised on May 24, 1979 and as further reduced by agreement of the Audit Division) is to be modified accordingly.


That the petition of Nu-Way Drug Center of Bohemia, Inc. is granted to the extent indicated in Conclusion of Law "C", and the notice of determination issued May 28, 1979 is to be modified accordingly.

That the petition of Nu-Way Drug Center, Inc. is granted to the extent indicated in Conclusion of Law "C", and the notice of determination issued on April 20, 1978 is to be modified accordingly.

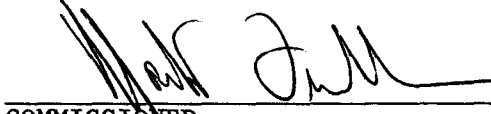
DATED: Albany, New York

STATE TAX COMMISSION

MAY 27 1983


PRESIDENT


COMMISSIONER


COMMISSIONER

P 481 207 901

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to <i>Nu Way Drug Center of Stony Brook, Inc. + Nu Way Drug Ctr. of Bohemia, Inc. + Nu Way Drug</i>	
Street and No. <i>c/o Erwin Popkin</i>	
<i>55 Mineola Blvd.</i>	
P.O., State and ZIP Code <i>Mineola, NY 11501</i>	
Postage	\$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return Receipt Showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	\$
Postmark or Date	

PS Form 3800, Feb. 1982

P 481 207 902

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to <i>Michael Salgo</i>	
Street and No. <i>Law Office of Erwin Popkin</i>	
<i>55 Mineola Blvd.</i>	
P.O., State and ZIP Code <i>Mineola, NY 11501</i>	
Postage	\$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return Receipt Showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	\$
Postmark or Date	

PS Form 3800, Feb. 1982