

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of :  
Victory Markets, Inc. : AFFIDAVIT OF MAILING  
for Redetermination of a Deficiency or Revision :  
of a Determination or Refund of Sales & Use Tax :  
under Article 28 & 29 of the Tax Law for the :  
Period 12/1/72 - 8/31/76. :

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State of New York }  
ss.:  
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon Victory Markets, Inc., the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Victory Markets, Inc.  
c/o Joseph W. Nishimura, Vice Pres.  
54 E. Main St.  
Norwich, NY 13815

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
6th day of April, 1984.

David Parchuck

James P. [Signature]  
Authorized to administer oaths  
pursuant to Tax Law section 174

STATE OF NEW YORK

STATE TAX COMMISSION

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ss.:  
County of Albany }

David Parchuck, being duly sworn, deposes and says that he is an employee of the State Tax Commission, that he is over 18 years of age, and that on the 6th day of April, 1984, he served the within notice of Decision by certified mail upon Thomas A. Vitanza, the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Thomas A. Vitanza  
Vitanza, Shabus & Fertig  
15 Maple St., P.O. Box 390  
Norwich, NY 13815

and by depositing same enclosed in a postpaid properly addressed wrapper in a post office 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  
6th day of April, 1984.

David Parchuck

James A. O'Hara  
Authorized to administer oaths  
pursuant to Tax Law section 174

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

April 6, 1984

Victory Markets, Inc.  
c/o Joseph W. Nishimura, Vice Pres.  
54 E. Main St.  
Norwich, NY 13815

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, a proceeding in court to review an adverse decision by the State Tax Commission may be instituted only 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  
Thomas A. Vitanza  
Vitanza, Shabus & Fertig  
15 Maple St., P.O. Box 390  
Norwich, NY 13815  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition	:	
	:	
of	:	
	:	
VICTORY 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 December 1, 1972	:	
through August 31, 1976.	:	

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Petitioner, Victory Markets, Inc., c/o Joseph W. Nishimura, Vice President, 54 East Main Street, Norwich, New York 13815, 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, 1972 through August 31, 1976 (File No. 20066).

A formal hearing was held before Frank W. Barrie, Hearing Officer, at the offices of the State Tax Commission, Building #9, State Campus, Albany, New York, on January 11, 1983 at 10:00 A.M., continued at the same location on January 13, 1983 at 10:00 A.M., and continued to conclusion at the same location on January 26, 1983 at 10:00 A.M., with all briefs to be submitted by June 17, 1983. Petitioner appeared by Vitanza, Shabus & Fertig, Esqs. (Thomas A. Vitanza, of counsel). The Audit Division appeared by Paul B. Coburn, Esq. (Harry Kadish, Esq., of counsel).

ISSUES

I. Whether the Audit Division properly determined that petitioner under-collected sales tax.

II. Whether the Audit Division properly determined that petitioner was liable for use tax on various leases of tangible property from its wholly owned subsidiary.

FINDINGS OF FACT

1. On September 6, 1977, the Audit Division issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due against petitioner, Victory Markets, Inc. (hereinafter, "Victory"), and Darryl R. Gregson, Joseph Y. Nishimura, Hamilton J. Smith, Paul T. Panico, Frank W. Willett, Frank L. Powell and Herman J. Asma, individually and as officers of the corporation. The Notice alleged that the following taxes, plus penalty and interest, were due based upon an audit of Victory's records:

<u>Period Ending</u>	<u>Additional Tax</u>
2/28/73	\$ 13,619.44
5/31/73	7,949.61
8/31/73	9,311.51
11/30/73	10,458.21
2/28/74	13,559.86
5/31/74	10,148.31
8/31/74	10,086.13
11/30/74	654.70
2/28/75	17,068.19
5/31/75	22,481.55
8/31/75	8,586.31
11/30/75	9,891.33
2/29/76	23,261.65
3/31/76	(2,113.71)
4/30/76	5,596.59
5/31/76	7,485.93
6/30/76	6,299.83
7/31/76	6,544.36
8/31/76	<u>6,219.62</u>
TOTAL	\$187,109.42

2. As the result of a conference, petitioner conceded that tax is due in the amount of \$37,307.31, and the Audit Division conceded that tax in the amount of \$45,535.98 should be cancelled. The sales and use taxes still in

dispute total \$104,266.13 which include an alleged undercollection of sales tax of \$85,565.99 and use taxes alleged due on certain leased property plus penalty and interest.

3. Petitioner is a retail supermarket chain. The number of stores ranged from seventy-four at the beginning of the audit period to seventy-eight at the close of the audit period. It is publicly owned with approximately 2,000 stockholders.

4. During the period at issue, petitioner had gross sales of \$508,854,314.88, which included taxable sales of \$125,797,694.79 on which it remitted sales tax of \$7,306,998.24.

5. The Audit Division alleges that petitioner undercollected \$85,565.99 in sales tax on its taxable sales of \$125,797,694.79. It based such determination on an examination of cash register tapes from thirty-two stores. It found what it considered useable tapes which corresponded to register reading reports for twenty-six stores for periods ranging from one to six days. Such six day period was for the week ending September 4, 1976. It determined that on taxable sales of \$21,261.10, Victory undercollected sales tax amounting to \$14.71. The Audit Division then divided this undercollection of \$14.71 by the total sales tax shown collected on the corresponding register reading reports of \$1,139.42 to arrive at a rate of error of .01291. This rate of error was applied to the sales tax collected in each jurisdiction reported by Victory on its tax returns for the period at issue to obtain sales tax due as a result of undercollection of \$85,565.99.

6. Petitioner's practice was to keep cash register tapes for only thirty days, and at the time of the audit, Victory had tapes for approximately thirty days of the audit period. Victory contends that it kept its tapes for the sole

purpose of controlling inventory shortages and not as accounting records.

Louis Redemann, Victory's director of internal audit, testified as follows:

"And one of the ways that we could find some of the reasons for those (inventory) shortages, we learned, was to expand the printing capability of our mechanical register... [B]y printing each and every item on the detail tape, we could then physically go down through the tape and look for small rings such as one penny, two cents, things that we wouldn't have anything for sale."

According to Victory, 886 miles of cash register tapes are produced by its stores annually and that it is unreasonable for the Audit Division to require the retention of such tapes for any considerable length of time. The Audit Division contends that no other record provides the transaction-by-transaction amount of sales tax collected.

7. Victory used approximately 370 to 380 Sweda cash registers in its stores during the period at issue. They were strictly mechanical registers that could only go in one direction. They could not subtract or void sales or run backwards. Sales tax was manually ascertained from a sales tax chart and then key entered into the register which would show the tax due. Furthermore, petitioner had only thirty-five to forty stores that used cash registers that printed full detail. The other registers only printed subtotals.

8. The Audit Division gave no credit for the overcollection of sales tax against the undercollection it asserted against petitioner. Nor did it make any adjustments for (i) refunds that were made on any taxable sale item, (ii) overrings,<sup>1</sup> (iii) sales to tax exempt customers, or (iv) "basket tests"<sup>2</sup> or

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<sup>1</sup> When the cashier makes an error by ringing up an item at an incorrect and higher price, an overring slip would be prepared because the registers could not minus or void transactions.

<sup>2</sup> Twenty-five items would be selected by a tester, about one-half would be taxable. Cashiers (aware that a test was being conducted) would be tested to determine their accuracy in ringing up the order. According to Jules Fox, Victory's vice president of personnel and training, each one of the 2,000 cashiers was "basket tested" once a month during the period at issue.

"shopping tests".<sup>3</sup> In fact, the auditor admitted that he was unaware that a supermarket chain makes refunds and has tax exempt customers. He admitted that he was aware of the basket tests conducted by petitioner, but gave no credit for such tests. An overring slip would be written up for "overrings", "basket tests" and "shopping tests". Refund slips would be prepared if a customer chose to return an item, and a refund slip for sales tax would be prepared for sales to tax exempt customers. These paper adjustments were included in the store manager's weekly cash reports. The auditors did not examine the weekly cash reports and the paper adjustments included therein.

9. Petitioner performed its own sampling and compared cash register tapes to corresponding register reading reports for the week before the Audit Division's test period. According to Mr. Redemann, "We didn't agree with it (the Audit Division's procedures to determine undercollection of sales tax), but we did it exactly the same way to see how it would come out on our own." Petitioner's test period was entirely within the period at issue, while the Audit Division's test period included four days outside of the period at issue. In addition, of the twenty-six stores used by petitioner in its own test, "(s)ome were the same, some were different" according to Mr. Redemann. Victory determined a rate of error of .00642 as compared to the Audit Division's rate of error of .01291. After considering overrings, refunds, and sales to tax exempt customers, petitioner reduced its rate of error to .00539. Petitioner contends that if overcollections are factored in, the error rate is further reduced by .00483 to

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<sup>3</sup> The shopping test was conducted by a security department employee who posed as a regular customer. According to Mr. Fox, the tester "would buy X number of items, taxable and non-taxable, ...for the purpose of seeing whether or not our cashiers (were accurate)...". The cashier was unaware that a "shopping test" was being conducted. Mr. Fox testified that cashiers were selected at random in various stores for the "shopping test". Every cashier in every store was not tested. Rather, over a three-month period, from one to three cashiers from each store would be tested.



.00056.<sup>4</sup> Petitioner did not introduce into evidence any documentation for its own audit.

10. According to Herbert Arkin, the distinguished statistician who testified on behalf of petitioner as an expert witness, the sample used by the Audit Division was not a true probability sample and, therefore, was not projectable. In addition, he contended that the Audit Division incorrectly took a simple average of the error rates at all stores rather than using a weighted average. A weighted average would require the Audit Division to multiply each rate of error for each store audited by the sales tax reported by that store. All the products would then be added up and divided by the total of sales tax collected to obtain a weighted error rate. For example, the error rate computed by the auditor's methodology is as follows for two sample stores:

<u>Store</u>	<u>Total Tax Reported</u>	<u>Sample Tapes Tax</u>	<u>Error</u>	<u>Error Percent</u>
#359	\$ 78,377.30	48.12	.77	.0160
457	192,361.54	15.58	.07	.0045
		<u>63.70</u>	<u>.84</u>	

$$\text{Average Rate} = \frac{.84}{63.70} = .0132$$

The weighted error rate would be determined as follows:

<u>Store</u>	<u>Total Tax Reported</u>	<u>Sample Error Rate</u>	<u>Product</u>
#359	\$ 78,377.30	.0160	\$1,254.04
457	192,361.54	.0044	846.39
	<u>\$270,738.84</u>		<u>\$2,100.43</u>

$$\text{Weighted Average Rate} = \frac{2,100.43}{270,738.84} = .0078$$

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<sup>4</sup> At the hearing herein, petitioner alleged that, after factoring in overcollections, there was an overpayment at a rate of .00036. It is unclear how they arrived at this figure instead of an undercollection at a rate of .00056 noted above.

11. Mr. Arkin further testified that the errors of undercollection of sales tax were apparently inadvertent errors of a clerical nature and "most of these errors seem to be of the same general form which tends to follow the Law of Large Numbers, namely, that they would wind up with a normal distribution, with an average of zero if you include both plus and minus errors."

12. Petitioner analyzed the errors discovered by the Audit Division in its sampling and determined that forty-five errors comprised \$9.47 of the total errors discovered of \$14.71. The rest were errors involving from one cent to six cents in undercollection of sales tax. Some of the larger errors were in the fifty cent to sixty cent range, and zero sales tax was collected. It is quite possible that where no sales tax was collected, the transaction involved a sale to a tax exempt customer. In addition, other larger errors in sales tax undercollected might possibly have involved refunds or overrings.

13. Petitioner, as a result of certain long-term borrowing, agreed with its lender, Mutual Insurance Company of New York, that it would not encumber any of its property with mortgages or liens. Consequently, petitioner utilized a wholly owned subsidiary, Dunco Realty and Equipment Corp. (hereinafter, "Dunco"), to acquire real estate, store equipment and vehicles. The borrowing to finance such transactions was done in Dunco's name. In addition, title to the various purchases was also in the subsidiary's name, and Dunco took depreciation deductions for the property. Liens ran from Dunco to its lender, Key Bank, Central New York.

14. For each transaction involving the purchase of equipment and/or vehicles by Dunco, it and Victory entered into a written lease agreement whereby Victory had "the absolute right, possession and control of the equipment and the use thereof during the term for which the equipment is leased hereunder

so long as Lessee (Victory) is not in default with any one or more of the terms and provisions of this lease." The sample lease, introduced into evidence at the hearing herein as petitioner's Exhibit "2", further provided for a term of seven years with the right to renew for five one year periods at the expiration of the initial seven year period. At the expiration of the lease, Victory under the lease agreement must surrender the leased equipment to Dunco.

15. Although Dunco maintained separate books and records, Victory was the disbursing agent for Dunco and payment for the equipment and vehicles was written on Victory's disbursing account. All equipment was ordered by Victory and was shipped directly to it. However, according to Mr. Nishimura's testimony, possession remains with Victory at the expiration of the lease. He testified that "As soon as the bank is paid off, the rent stops."

16. Sales tax was paid on all of the equipment and vehicles, covered by the leases at issue, to the manufacturer or retailer on its initial purchase. The Audit Division initially gave Victory a credit of \$59,145.65 for sales tax paid for all purchases on which refunds were not barred by the statute of limitations. As noted in the Audit Division's Exhibit "H" herein, this credit "was (further) increased by \$5,295.18, representing Topco invoices on which the vendor paid tax." Therefore, the total credit allowed was increased to \$64,440.83 against the use tax of \$77,845.79 alleged to be due by the Audit Division as a result of the lease agreements between Dunco and Victory.

#### CONCLUSIONS OF LAW

A. That under Tax Law §1138(a), there is statutory authority for the use of a "test period" to determine the amount of sales tax due. However, resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify that the proper

tax was collected on taxable sales. See Matter of Chartair, Inc. v. State Tax Commission, 65 A.D.2d 44.

B. That pursuant to Tax Law §1135, petitioner was required to "keep records of every sale...and of all amounts paid, charged or due thereon and of the tax payable thereon...". In addition, "(s)uch records shall include a true copy of each sales slip...". Since petitioner's cash register tapes were the only records which indicated the exact amount of tax collected on each and every sale, petitioner was required to keep such tapes under §1135 "for a period of three years, except that the tax commission may consent to their destruction within that period or may require that they be kept longer".

C. That from the cash register tapes retained by petitioner, the Audit Division could not determine if sales tax was properly collected on all taxable sales during the audit period since (i) tapes were not available for the entire audit period but only for approximately one month within the audit period, and (ii) some tapes were not useable as noted in Finding of Fact "5", supra. Therefore, the Audit Division properly resorted to a test period analysis. See Matter of Carl J. Licata, et al., State Tax Commission, July 13, 1983.

D. That the Audit Division's failure to consider refunds, overrings and sales to tax exempt organizations while conducting its audit was not in accordance with the realities of the retail supermarket business. In addition, it was unreasonable for the auditor to fail to give credit for "basket tests", as noted in Finding of Fact "8", supra, when in fact he had knowledge that petitioner conducted such tests. Furthermore, a weighted averaging of error rates, as noted in Finding of Fact "10", supra, would have been a more reasonable method of estimating the undercollection of tax given the large number of stores

operated by petitioner. Therefore, we conclude that petitioner did not under-collect sales tax.

E. That Tax Law §1110 imposes compensating use tax "for the use within this state...of any tangible personal property purchased at retail...". Tax Law §1101(b)(5) defines "purchase" as:

"Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume, conditional or otherwise, in any manner or by any means whatsoever for a consideration..."

Therefore, the leasing of various equipment and vehicles by petitioner from Dunco was properly subject to tax under Tax Law §1110. Petitioner cited In Re Sherwood Diversified Services, Inc., 382 F.Supp. 1359 (1974) in support of its position that Dunco was a financing agency rather than a lessor who was liable for sales tax on its leasing of equipment and vehicles.<sup>5</sup> The court in Sherwood considered twelve factors, all of which supported their conclusion that the "lessor" in Sherwood was a financing agency and not a lessor who must collect sales tax from its customers on leases. Four of the twelve factors lead to a different conclusion herein: (1) financing statements under the Uniform Commercial Code were not executed and delivered to Victory, rather they were executed and delivered to Dunco; (2) there is no evidence that the lease agreements herein were discounted with a bank or other lending institution; (3) Dunco carried the leased property as assets on its books, unlike the corporation in Sherwood which carried the assets on its books as accounts receivable; and (4) Dunco took depreciation deductions on the equipment and vehicles, unlike the Sherwood corporation which did not take any depreciation deductions.

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<sup>5</sup> Since no sales tax was collected by Dunco on such leasing, the Audit Division imposed a use tax against Victory as noted in Finding of Fact "2".

Therefore, we conclude that although Dunco was used by petitioner to facilitate its purchase of equipment and vehicles, it cannot be said that Dunco was merely a financing agency. Furthermore, as noted in Finding of Fact "16", supra, the Audit Division properly credited sales tax paid on the initial purchases to the extent that such credits were not barred by the statute of limitations, or \$64,440.83.

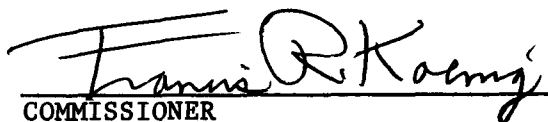
F. That the petition of Victory Markets, Inc. is granted to the extent noted in Conclusion of Law "D", supra, but, in all other respects, is denied.

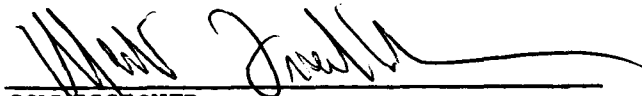
DATED: Albany, New York

STATE TAX COMMISSION

APR 06 1984

  
PRESIDENT

  
COMMISSIONER

  
COMMISSIONER

P 440 976 944

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—  
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to	
Thomas A. Witanza	
Street and No.	
15 Maple St. P.O. Box 1390	
P.O., State and ZIP Code	
Pawtucket, NY 13815	
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 440 976 943

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED—  
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to	
Victory Markets,	
Street and No.	
542 Main St.	
P.O., State and ZIP Code	
Pawtucket, NY 13815	
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