

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
RAEMART DRUGS, INC.	:	DETERMINATION
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 April 1, 1981	:	
through February 29, 1984.	:	

Petitioner, Raemart Drugs, Inc., 1221 Avenue of the Americas, New York, New York 10020, 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 April 1, 1981 through February 29, 1984 (File No. 65435).

A hearing was commenced at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on October 29, 1986 at 1:15 P.M. and continued to conclusion on January 29, 1987 at 9:45 A.M., with all briefs to be submitted by May 28, 1987. Petitioner appeared by Arnold B. Panzer, Esq. The Audit Division appeared by John P. Dugan, Esq. (Michael B. Infantino, Esq., of counsel).

ISSUE

Whether the Audit Division properly denied petitioner's claim for refund of sales taxes assertedly overpaid during the period April 1, 1981 through February 29, 1984.

FINDINGS OF FACT

1. Petitioner, Raemart Drugs, Inc., is a corporation engaged in the retail drug store business in New York City through three separate stores. In addition to its sale of prescription drugs, petitioner sells approximately 20,000 different items including cigarettes (both by the pack and carton), candy, magazines, non-prescription medications, toiletries, personal care products and numerous other items.

2. On April 24, 1984, petitioner filed thirteen applications for credit or refund of state and local sales or use tax, spanning the period April 1, 1981 through February 29, 1984, seeking a refund of sales tax paid for such period in the total amount of \$180,357.00, plus interest. Each application contained the following explanation as to the basis for the claim for refund:

"Taxpayer included the sales applicable to cigarettes as taxable volume. In addition payment of the tax applicable to the cigarette sales was then remitted within the quarterly report."

3. Each day, petitioner handles transactions involving approximately 5,000 different customers, and its cash registers yield a daily total of over 50 separate rolls of tape. The type of cash registers employed by petitioner are typical of those used in the retail drug store business. Such registers indicate when and how much sales tax has been added onto an item, but do not record the nature of the item sold.

4. During the period in question petitioner filed quarterly and part-quarterly sales and use tax returns. Petitioner computed its sales and use tax liability using a 58% taxable ratio applied to its gross sales to arrive at taxable sales. This taxable ratio was based upon the results of a field audit performed by the Audit Division, which audit covered prior periods, specifically September 1, 1976 through February 28, 1979. This prior audit had found a taxable ratio on petitioner's gross purchases of 58.427% and a markup thereon of 30.9%. The audit resulted in a finding of additional taxable sales of \$176,342.00, and additional sales tax due thereon of \$14,179.00, which petitioner had agreed to and paid. Petitioner had filed its sales tax returns on the basis of an estimated taxable ratio prior to the time of this audit. During the period involved in the instant refund claim, petitioner filed on the same basis, although using the higher taxable ratio (58%), as found by the Audit Division upon audit.

5. In filing its returns petitioner, as noted, computed its tax liability based on a ratio of 58% of its gross sales. In addition, petitioner added to the tax on 58% of its sales, an additional amount computed as the tax due on its sales of cigarettes, notwithstanding that cigarette sales were included as part of the 58% of gross sales upon which tax was computed.

6. In order to assist its cash register operators in correctly identifying those items on which

tax was to be charged and collected in accordance with guidelines established in the prior audit, petitioner "color coded" its price stickers (subsequent to the above-described audit), such that all cigarettes and candy on which tax was to be collected bore one color and those items which were tax free (other than newspapers and magazines) bore another. Petitioner instituted this system to help insure that tax was correctly added at the register.

7. Subsequent to the filing of the aforementioned refund applications, the Audit Division conducted an audit of petitioner's books and records for the period April 1, 1981 through November 30, 1984.¹ Petitioner had not maintained cash register tapes for such period, and the Audit Division conducted its audit utilizing a test period spanning March 1, 1984 through May 31, 1984. The auditor reviewed invoices for such period and determined a taxable ratio of 59.738%, which was applied to petitioner's gross purchases to arrive at taxable purchases for the audit period. A markup percentage was not calculated. Rather, taxable purchases, as determined, were marked up by 30.9% based on the markup percentage determined on the prior audit, thus resulting in audited taxable sales of \$19,035,934.00. This figure was compared to petitioner's reported taxable sales of \$20,525,368.00 resulting in estimated overreported taxable sales of \$1,489,434.00, and a possible overreported sales tax payment of \$122,738.07. Based on the findings of this audit, the Audit Division accepted that no additional tax was due.

8. On August 12, 1985, the Audit Division notified petitioner in writing that its refund claims totalling \$180,357.00 were "denied in full, based on TSB-H-82(167.1)S, (That petitioner failed to maintain the records required under Section 1135 of the Tax Law, and in the absence of such records petitioner cannot establish the exact amount of sales tax liability for the periods claimed for refund)."

9. Petitioner timely filed a petition to contest the Audit Division's disallowance of petitioner's claim for refund. Its petition indicated the amount of refund sought was \$180,357.00.

¹This audit was a "large vendor" audit, and encompassed three periods beyond the periods for which refund is claimed.

10. At the commencement of the hearing, petitioner submitted an amendment to its petition wherein, inter alia, the amount of refund claimed was reduced from \$180,357.00 to \$141,192.00. This reduced amount reflects petitioner's calculation of the "additional amount remitted for cigarettes". Finally, in its brief and in its proposed findings of fact petitioner indicated a minimum overpayment of \$140,890.00 for which refund is demanded. This amount was asserted to be the amount of additional sales tax remitted based and calculated upon sales of cigarettes by petitioner.

11. As authorized, the tax collected by petitioner with respect to the sale of cigarettes was included in the total price at which such cigarettes were sold to the public. This method, known as the "unit price method," is based on calculating sales tax on cigarettes after the exclusion of New York State and City cigarette excise tax but with inclusion of the Federal Excise Tax imposed on manufacturers and importers.

12. As noted, petitioner's sales tax returns were filed in a manner whereby 58% of gross sales were estimated to be taxable sales and tax was computed thereon. In addition, on the reverse of the returns petitioner calculated the sales tax applicable to cigarettes and included such amount of tax with the filing of the returns. Review of those returns submitted in evidence appears to indicate that an employee of the Audit Division "crossed out" the amount of taxable sales stated on the front of the returns and restated such amount to equal the amount of taxable sales necessary to generate the amount of sales tax remitted.

13. It has been petitioner's consistent position herein that since the taxable ratio of 58% as determined on audit included therein sales of cigarettes, petitioner should have adjusted the measure of taxable receipts so as to eliminate from the tax base the sales price of the cigarettes for which a tax was being separately stated on each return. Petitioner asserts that through a failure of communication and/or an inadvertent oversight on the part of its accountant, no adjustment whatsoever was made in the computation of gross and taxable receipts to eliminate therefrom sales of cigarettes, to the effect that the tax collected by the petitioner with respect to

the cigarettes which it actually sold during the taxable periods in issue was inadvertently reported and remitted twice with its returns.

14. Matthew Rodgers, the accountant who prepared each of the returns in issue (as well as the above-mentioned claims for refund) testified at the hearing that the alleged overpayments in question resulted from his confusion concerning the intricacies of the sales taxation of cigarettes in New York State. Sometime prior to preparation of the returns in issue, Martin Funt, one of the principal officers of petitioner, had suggested that Mr. Rodgers compute the tax due on sales of cigarettes separately from the tax on other sales, a procedure which Mr. Funt understood to be a common practice with respect to substantial vendors of cigarettes in New York City. Thereafter Mr. Funt supplied information concerning cigarette sales for the taxable period, along with a number which he understood from discussions with colleagues in the retail drug store business to be the amount of sales tax due with respect to each carton sold in New York City, based on the prices then charged.

15. Mr. Funt anticipated that in the course of separately computing a tax based on cigarette sales alone, Mr. Rodgers would first deduct the amount of gross receipts attributable to sales of cigarettes from the total amount of gross sales on which taxable sales were computed using the estimated 58% taxable ratio. However, Mr. Rodgers asserted that he added the amount of tax computed with respect to cigarettes alone (based on the above information supplied by Mr. Funt) to the sales tax computed on 58% of petitioner's total gross sales. Mr. Rodgers testified that he had either failed to realize or recall that the taxable ratio of 58% had included cigarettes, and that it was not until after all of the returns in issue had been filed that he discovered he he had assertedly double-reported and paid the sales tax attributable to petitioner's sales of cigarettes. The initial amounts for which refunds were claimed (\$180,357.00) were thereafter essentially computed by removing the total sales allegedly attributable to cigarettes from gross sales, and multiplying the balance by 58% to arrive at the amount of taxable sales, with the refund amount being the difference between such amount and the amount of tax reported and paid by petitioner.

16. Petitioner asserts, with respect to its method of reporting its sales tax liability, that given the nature of its business, the large number of different items sold and the volume of transactions, it is impractical if not impossible to separately record the nature of each item sold and to segregate by item whether an item is taxable or nontaxable. Petitioner asserts that cash registers which not only indicate whether an item is taxable but also indicate the individual nature of the item are impractical for use in petitioner's business due to their cost, and maintains that such cash registers are essentially used only in a relatively small number of supermarket chains with their principal function being to keep track of the store's inventory for stocking purposes. Thus, petitioner asserts it is impossible to determine its taxable sales from an item-by-item review of the cash register tapes and impractical to manually record at the time of sale the nature of each of the thousands of items being sold. Accordingly, petitioner maintains its method of computing, reporting and paying tax is the only practical and acceptable method available.

17. At the hearing, the auditor admitted that the only records which the taxpayer did not have available which might have been consulted in the course of the audit examination were cash register receipts. Petitioner possessed an essentially complete set of invoices², and also cash receipts and cash disbursement journals, a general ledger, entry sheets, complete bank statements, Federal, State and City tax returns and related worksheets, sales tax returns, depreciation schedules, a check register, cancelled checks, and monthly bank statements.

18. Messrs. Rodgers and Funt both testified that prior to the audit of its 1976-1979 sales tax returns (the audit in which the 58% taxable ratio was computed), it was always petitioner's practice to save, mark and store all cash register tapes. However, after allegedly being informed by the persons conducting the audit that they were not required to examine the cash register tapes, and had no interest in doing so, petitioner's principals concluded that cash register tapes

²Although there were a few invoices which the taxpayer was unable to produce, the auditor conceded that their significance was not such as to prevent him from determining petitioner's taxable sales "within his usual level of exactitude."

were not the type of records required to be saved for audit purposes, and that it was pointless to attempt to save them for any longer period than was required for their own accounting purposes.

19. When questioned with respect to the significance of the absence of cash register tapes, the auditor stated that the availability of such tapes would not have affected the manner in which he would otherwise have conducted his audit, nor would their presence have been sufficient to establish taxpayer's right to a refund, since the tapes produced by petitioner's cash registers did not identify the particular items sold in each transaction. The auditor also stated that the exact amount of the tax collected from customers could not be determined even in theory on the basis of the cash register tapes since no tax would be indicated on the tapes with respect to cigarette sales.

20. Petitioner submitted proposed findings of fact numbered "1" through "28", each of which was considered in the rendering of this determination, as follows: proposed findings "1", "2", "5", "13", "14", "18", "23", "24" and "25" are accepted in whole and are incorporated herein; proposed findings "3", "11", "12", "26" and "27" are accepted and incorporated in part, but are rejected to the extent they are conclusory in nature and/or irrelevant to the issuance of a determination herein; proposed findings "4"³, "6", "10", "16" and "22" are rejected as being conclusory in nature; proposed findings "7", "8", "9" and "28" are rejected as repetitious and/or irrelevant, given that the facts found herein set forth the method of audit employed in this case; proposed finding "15" is rejected insofar as it is arithmetically inaccurate; proposed finding "17" is accepted (with the chart therein specifying individual quarterly periods and amounts omitted as unnecessary); and proposed findings "19", "20" and "21" are rephrased to eliminate conclusory phraseology and, as rephrased, are incorporated herein.

CONCLUSIONS OF LAW

³Although rejected as an affirmative fact, such proposed fact is set forth as a statement of the position taken by petitioner herein (see Finding of Fact "16").

A. That Tax Law § 1135(a) provides, in pertinent part, that:

"Every person required to collect tax shall keep records of every sale...and of the tax payable thereon, in such form as the tax commission may by regulation require...." (See 20 NYCRR 533.2[b][1]; 20 NYCRR 533.2[a][1].)

B. That petitioner did not maintain such records of each individual sale, as required by Tax Law § 1135, as would enable a determination of the exact amount of sales tax liability, and prove the correctness of petitioner's returns as filed. Rather, petitioner chose to file its returns on the basis of an estimate of its taxable sales, with such estimate being based on an Audit Division audit which itself utilized indirect methodologies in arriving at its results.

C. That Tax Law § 1138, together with a long-standing line of case law, authorizes the use of the audit procedures described herein as a means of estimating taxes due when there are insufficient books and records to determine with exactness sales tax liability and the correctness of returns. (See ___, e.g., *Matter of Urban Liquors, Inc. v. State Tax Commn.*, 90 AD2d 576; *Matter of Licata v. Chu*, 64 NY2d 873; *Matter of Grant v. Joseph*, 2 NY2d 196.)

D. That in order to establish entitlement to a refund, petitioner was required to demonstrate, inter alia, the amount of its sales tax liability during the period. (*Matter of Saltzman v. State Tax Commn.*, 101 AD2d 910.) Here, given the method by which petitioner computed its tax liability, petitioner cannot point with any specificity to the exact amount of tax which was due and, in turn, cannot prove that taxes were overpaid during the period in issue.

E. That the various methods utilized by petitioner in calculating its liability and filing its returns, and by the Audit Division in auditing the same, are indirect methods designed to arrive at some reasonable approximation of the amount of tax due, but are not designed for or guaranteed to arrive at the exact and actual amount of tax due. Given that such methods do not determine the exact amount of taxable sales, nor the exact amount of tax liability, such procedures are not satisfactory for the purpose of proving that a refund is due (*Matter of Saltzman*, supra;

Matter of Pearlstone Pharmacy, Inc., State Tax Commn., November 10, 1983; see Matter of Sloan's Holding Corp. et al., State Tax Commission, May 26, 1987). While there is some evidence pointing to the possibility of an overpayment by petitioner, including the results of the Audit Division's audit, as well as the manner in which petitioner separately stated the cigarette sales and tax due thereon on its returns, petitioner nonetheless has not established its actual tax liability for the period in question, and thus has not proven that the amount remitted to the State was more than the amount of its liability. Accordingly, petitioner's claim for refund must be denied.

F. That the petition of Raemart Drugs, Inc. is hereby denied and the Audit Division's denial of petitioner's claim for refund is sustained.

DATED: Albany, New York
November 16, 1987

ADMINISTRATIVE LAW JUDGE