STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
MARINE MIDLAND BANK, N.A.	:	DETERMINATION DTA NO. 807533
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, 1983 through November 30, 1985.	:	

Petitioner, Marine Midland Bank, N.A., One Marine Midland Center, Buffalo, New York 14203, 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, 1983 through November 30, 1985.

A hearing was commenced before Jean Corigliano, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on May 28, 1991 at 1:30 P.M., continued on May 29, 1991, and continued to completion on May 30, 1991. Petitioner submitted a pre-hearing brief on May 24, 1991 and post-hearing briefs on September 3, 1991, and December 18, 1991. The Division of Taxation filed post-hearing briefs on November 5, 1991 and February 18, 1992. Thereafter, the Division of Taxation submitted two decisions of the New York State Court of Appeals, issued after the submission of briefs, in support of its position. Petitioner, on March 19, 1992, filed a responding letter brief.

Petitioner appeared by James A. Locke, Esq., and Martha L. Salzman, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Patricia L. Brumbaugh, Esq., of counsel).

ISSUES

I. Whether the notice of determination issued to petitioner was invalid because it failed to indicate that the tax assessed was estimated as provided for in Tax Law § 1138(a)(2).

II. Whether the Division of Taxation was authorized by Tax Law § 1138(a)(1) to employ a computer assisted statistical sampling methodology to determine petitioner's sales and use tax liability where petitioner maintained a complete and adequate set of books and records.

III. Whether petitioner has demonstrated reasonable cause to support the abatement or cancellation of penalties under Tax Law § 1145.

FINDINGS OF FACT

Petitioner, Marine Midland Bank, N.A., and the Division of Taxation ("Division") executed a Stipulation of Facts pursuant to 20 NYCRR 3000.7. The stipulated facts have been substantially incorporated into the following Findings of Fact.

Petitioner is a national banking association, with an office at One Marine Midland Center, Buffalo, New York. During the audit period, March 1, 1983 through November 30, 1985, petitioner was engaged in a commercial banking business. Petitioner's taxpayer identification number is 16-1093160. Petitioner is one of the nation's largest banks providing a full range of commercial, corporate, international, retail and fiduciary banking services to corporations, institutions, governments, and individuals. Petitioner has an extensive banking network in New York State with about 300 branch offices and has regional offices in Rochester, Syracuse and New York City. Its headquarters are in Buffalo, New York. Petitioner has numerous automated teller machines ("ATM's") and point of sale electronic banking facilities throughout New York State. Petitioner provides credit cards to consumers in over 40 states through financial institutions affiliated with its Par Agent national credit card program.

As a result of a computer-assisted audit which included the statistical sampling of petitioner's books and records, the Division issued to petitioner a Notice of Determination and Demand for Payment of Sales and Use Taxes Due, dated February 24, 1988, assessing additional sales and use tax due of $968,240.69 for the period March 1, 1983 through November 30, 1985 plus a penalty of $247,469.04 and interest (computed at the penalty rate). All of the additional tax due was related to petitioner's purchases of tangible personal property and taxable services.[1]

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[1]Petitioner's taxable sales included the sale of checks and checkbook covers and repossessed vehicles and the rental of safe deposit boxes. The audit found no additional tax due in the area of taxable sales.

The notice of determination issued to petitioner contained the following statements:

> "The tax assessed above has been estimated in accordance with the provisions of section 1138(a)(1) of the Tax Law." [This statement was preceded by a box.]
>
> "If the box above is checked see additional information on back of this notice. If the box above is not checked, the tax has not been estimated."

The box referred to on the notice of determination was not checked.

Prior to the issuance of the notice of determination for the audit period, petitioner and the Division agreed to fix the amount of additional tax and interest due on certain AT&T long line telephone charges at $343,977.81 and $94,666.49, respectively. Petitioner paid these amounts in February 1988. The Division did not assert a penalty with regard to these transactions because AT&T did not collect tax from any of its customers and petitioner was not aware that the services were subject to tax.

By letter dated June 9, 1988, from Gordon A. Farquahar, Vice President and Manager of Corporate Tax Planning for petitioner, to Michael J. Pistolese of the Division's Buffalo District Office, petitioner remitted $748,000.00 of the assessed tax and $256,839.39 of the assessed interest, to be allocated among the quarters included in the audit period. The letter stated, in part:

> "Please note that this payment does not constitute a consent to the allegations contained in and/or pertinent to the Notice of Determination and Demand for Payment of Sales and Use Tax Due dated February 24, 1988, and does not constitute an admission or implication that any amount of tax is due or owing for the taxable periods listed above."

In this proceeding, petitioner contests the full amount of the tax assessed for the audit period, $968,240.69, plus penalty and interest. Accordingly, petitioner seeks a refund of the amount paid, $1,005,139.39, and cancellation of the remainder of the tax assessment ($219,940.69).[2]

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[2]Petitioner timely filed a petition in this matter on November 1, 1989, contesting tax in the amount of $219,940.69, plus penalty and interest. At hearing, petitioner was granted permission to amend its petition to challenge the validity of the notice of determination, on the ground that the notice failed to indicate that the tax assessed was estimated. By Notice of Motion dated

Petitioner's books and records for the audit period are adequate, sufficient and substantially complete and were available for examination by the Division.

Petitioner fully cooperated with the Division throughout the audit. Petitioner did not consent to the Division's use of a computer- assisted statistical sampling method of auditing petitioner for the audit period. The Division never specifically requested petitioner's consent to the use of a computer-assisted statistical sampling audit method or to any other method of auditing petitioner's books and records. Petitioner did not, prior to the concluding conferences for the audit, expressly object to the use of the computer-assisted statistical sampling method of conducting the audit.

The Computer Assisted Statistical Sampling Audit Program

There are approximately 500,000 registered sales tax vendors in New York State. The Division classifies between 2,000 and 2,500 of these as "large vendors", those reporting sales tax due of over $125,000.00 per quarterly sales tax period. The Division conducts 5,000 to 7,000 field audits annually; it seeks to examine the returns of each of the large vendors every three years, with some 450 to 600 such audits scheduled each year. It employs approximately 400 sales tax auditors, each of whom works directly on audit related functions 185 days per year. With this available staff, it would not be possible for the Division to conduct even a small number of large vendor audits which examine each and every transaction on an item-by-item basis.

To carry out its audit function with available staff the Division has developed a variety of audit methodologies. Limited scope audits concentrate on specific areas to audit. Block audits involve the use of a team of auditors for a specified period of time. Computer-assisted

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August 29, 1991, petitioner informed the Administrative Law Judge that it would move, on October 21, 1991, for permission to amend its petition a second time to change the amount of tax contested from $219,940.69 to $968,240.69. By letter dated October 6, 1991, the Division informed the Administrative Law Judge that it would not oppose petitioner's motion. Petitioner's motion to amend was granted by letter dated April 14, 1992. Petitioner filed a second amended petition on April 20, 1992.

audits allow the Division maximum use of the auditor's time. A statistical sampling audit is one type of audit made possible by computer assistance, but all computer-assisted audits are not statistical sampling audits. The statistical sampling method was developed by the staff of the Division's Electronic Data Processing Systems Audit Bureau ("EDP"), assisted by an independent authority on statistical sampling audits, Herbert Arkin, Ph.D.

The Division presented the testimony of Donald M. Roberts, Ph. D., an expert in the field of statistics and public accounting, hired by the Division to review and evaluate the Division's statistical program in the area of sales tax audits. Dr. Roberts concluded that the Division's statistical sampling methodology conforms to sound statistical principles and that the results of audits conducted using that methodology are statistically valid. Dr. Roberts submitted a report suggesting some changes in the Division's statistical sampling program, but those changes were recommended to improve efficiency and do not affect the validity of the program.

In the course of his testimony, Dr. Roberts described many of the concepts underlying the statistical sampling methodology. Some of his observations are pertinent here. He stated: "Statistical sampling actually is a methodology that allows you to examine all items in a population by selecting just a few." (Transcript at 235.) It differs from a test period audit in at least one significant way. In a test period audit, the results of a block of time (or test period) are projected over a longer period. The accuracy of the results rests upon the representativeness of the test period selected and, consequently, the judgment of the auditor who selected the test period. There is no scientific methodology to assess how well the auditor exercised his or her judgment in selecting the test period. The statistical sampling methodology is based upon mathematical principles and laws of probability and chance and allows for measurement and control of the error factor. The error is quantified in the precision factor.[3] Statistical sampling

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[3]"Precision" in statistics is a statement of how close the result of a particular sample should be to the result which would be obtained if every item in the "universe" was examined. Given the size of the sample and the magnitude of each error identified, the precision is described as $\pm$ an amount. Sampling error is expressed in terms of percentages, while the precision factor is expressed in dollar value amounts.

is a particular type of estimating procedure, and it is very unlikely that two samples from a population will yield identical results.

The Internal Revenue Service employs statistical methodologies in auditing taxpayers as does the State of Illinois. Dr. Roberts has served as a consultant to both of these jurisdictions. Based on his knowledge and experience, he stated that a 95% confidence level, the level achieved in this audit, is an accepted standard.

Computer-assisted audits are conducted by field audit staff in the Division's district offices with technical assistance from specialists in EDP. EDP staff review the machine sensible electronic data available from a taxpayer's computerized recordkeeping system and determine whether a statistical sampling method can be conducted with the records available from the taxpayer. If a statistical sampling audit is conducted, EDP staff provide the statistical analysis of data produced from a field auditor's review of randomly selected sample items.

The Division also conducts test period audits. The major difference between a test period audit and a statistical sampling audit is that the former involves a test of all records within a portion of an audit period (usually one to three months), while the latter samples randomly-selected items from the entire audit period. The Division does not request the consent of the taxpayer before performing a statistical sampling audit, but it does seek consent to perform a test period audit where it determines that a taxpayer's records are complete and adequate for the purpose of performing a detailed audit. It does not seek consent to a statistical sampling audit because it takes the position that this methodology utilizes all of the taxpayer's books and records.

The Division used a computer-assisted statistical sampling method to audit petitioner's sales tax returns for the audit period. This audit was generally consistent with the Division's procedures for such audits; therefore, a description of the actual audit conducted will also serve to describe the Division's statistical sampling audit program.

Audit of Petitioner

Potential candidates for computer assisted audits are first identified by the Division's District Office Audit Bureau. These candidates are asked to provide information which allows the Division to determine whether such an audit is feasible. The most important factor considered by EDP in making such a determination is whether the taxpayer utilizes a computer system which is compatible with the Division's own computer hardware and software systems. In July 1985, petitioner was asked by the Division to complete a Computer Audit Feasibility Questionnaire, which it did. EDP reviewed the completed questionnaire and determined that the Division was able to audit petitioner using computer-assisted techniques.

The sales tax field auditor assigned to this matter, Paul Barto, was contacted by EDP and instructed to schedule a meeting between the Division and petitioner's representatives. That meeting was held on November 26, 1985 at petitioner's offices. The meeting was attended by Mr. Barto, his supervisor, John Neeb, Angelo Gazzo, a second auditor, and Andy Blumbergs of EDP, on the Division's side, and by David R. Sharp, petitioner's Assistant Vice-President, Ida Mae Raoff, Donna Zeller, and Ed Wisniewski representing petitioner. Mr. Blumbergs explained the computer-assisted audit program and the statistical sampling methodology to petitioner's representatives. He was asked several questions which he agreed to respond to in writing. Consequently, by letter dated November 27, 1985, the Division described to petitioner its expected plan for carrying out the computer-assisted audit. In addition, the Division cited to several legal authorities to support its position that under its general authority to inspect and examine a taxpayer's books and records it is authorized to request and examine magnetic tapes, discs, punch cards, computer printouts and any other machine sensible data used to record, consolidate and summarize the taxpayer's accounting transactions. Notably, the Division's letter made no reference to its authority to determine a taxpayer's sales tax liability by means of a statistical sampling methodology.

In accordance with the audit plan outlined in the letter, Paul Barto and John Neeb met with David Sharp on December 10, 1985, at petitioner's offices, to review petitioner's chart of accounts and to identify those most likely to include purchases subject to sales tax. Since

petitioner conducted business throughout New York and outside New York, its distribution of accounts was maintained by cost centers (geographic location or operational units); therefore, the accounts were examined to limit the audit to transactions which occurred in New York. Six asset accounts were selected for audit and over 100 expense accounts.

From its master accounts payable/distribution file, petitioner created and transmitted to the Division audit files on magnetic tape. These files contained a detailed record of every accounts payable transaction made by petitioner during the audit period. The magnetic tape and audit files contained sufficient information to allow retrieval of microfilm copies of the original source documents for each transaction (excluding April 1984).

The audit files received from petitioner were first converted from the tape format in which they were received to a format compatible with the Division's computer system and software. From the audit files, the Division created two separate files (referred to as "universe" files), one file for assets and the other for recurring expense purchases. This was done because the Division planned to, and did, audit each of these areas separately. EDP then generated a number of summary reports. A location and cost summary report was generated to identify all locations in New York where petitioner made purchases subject to sales tax. An "account summary" report was produced which summarized the total dollars and transaction volume in each separate account. A "data summary" account was produced which summarized the same information on a monthly basis. The Division used the account summary and data summary analyses to verify the accuracy of the contents of the audit files.

The summary reports were transmitted to Mr. Barto who compared the amounts shown to petitioner's general ledger. This comparison is made as one step in a computer-assisted audit to ensure that a taxpayer's records are complete and reliable. In this case, there were no significant discrepancies and Mr. Barto so informed EDP.

After verifying the accuracy of the audit files, EDP summarized the transactions in the expense universe and the asset universe by dollar ranges ("strata") and determined the total number of transactions ("population") within each dollar range ("stratum"). It then produced

"profile reports" which show the number of strata in each universe (9 actual strata in both the expense and asset universes); the actual dollar ranges in each of the 9 strata ($0 - $100; $100 - $500; etc.); the number of transaction items in each dollar range or stratum; and the total dollar value of all transaction items within a stratum. The computer calculated other factors from this information, e.g., the average dollar value of each transaction within a stratum; the median dollar value of each transaction within a stratum, the standard deviation, and the ratio of the dollar value of all transactions within a stratum to all transactions in the universe (expressed as a percentage). The profile reports included an unnumbered stratum for credit transactions.

The profile report aids EDP in determining which strata are to be audited in detail and which are to be audited by statistical sampling. It also provides information which EDP uses to adjust the dollar range and sample size if necessary. In this case, EDP chose to review in detail all of the expense transactions in stratum 9 ($20,000.00 - $99,999,999.99) and all of the asset transactions in strata 7, 8, and 9 ($7,500.00 - $99,999,999.99), and all credit transactions. Items in all other strata were statistically sampled. The selection of particular items for the statistical sample was made by use of a random number generating computer program.

The next step in auditing petitioner's records was the preparation of two "pull reports", one for expenses and one for assets. The pull reports list the specific sample items to be examined by the auditor along with information needed to retrieve those items from the taxpayer's files, in this case: the transaction date, vendor name, voucher number, cost center identification number, account number and the amount of the transaction.[4] The pull reports also have blank spaces for information to be inserted by the field auditor. On the pull reports, credit transactions are noted as stratum 11. The pull reports were forwarded to the field auditor and a copy of each was presented to petitioner.

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[4]Petitioner maintains its accounts by type of transaction, and petitioner's accounting system distributes items on a single invoice to the appropriate account. The transactions audited by the Division (the sample items) were the individual items distributed to an account, not an entire invoice. Each item is identified by a voucher number which allows for the retrieval of source documents related to the item.

Petitioner maintained copies of original source documents, in this case sales invoices, vouchers, purchase orders and other supporting documentation, on microfilm. The auditor examined over 3,082 purchase items in the asset universe and 3,811 purchase items in the expense universe, using petitioner's microfilm and microfilm reading equipment. A transaction which does not comply with the provisions of the sales tax law is referred to by the Division as an "exception item". When the auditor's review of a transaction indicated that it was a potential exception item, he made notations on the pull report indicating the amount of the transaction, the location code, the proper tax rate and the amount of tax due. The auditor here also provided a brief description of the item subject to tax (e.g., credit report, rubbish disposal, paint walls and ceilings). Where tax was

properly charged, the auditor placed a zero on the pull report. The auditor made hard copies of the invoices on which exception items appeared using the microfilm equipment. The exception items were then reviewed with petitioner's staff and petitioner was provided an opportunity to provide further documentation to assist the Division in determining whether additional tax was owing on the transaction. The auditor also researched the proper treatment of potential exception items using publications of the Division and administrative law decisions. If a potential exception item was determined to be not subject to additional tax, the amount of the transaction was changed to zero on the pull report.

The statistical sample included a number of items for charges by AT&T for long line telephone service within New York State. Because of the large amount of tax related to this one category, petitioner requested that the AT&T charges be addressed separately. This was accomplished by treating all AT&T items in the statistical sample as no change items, and generating a separate listing of the AT&T vouchers. Petitioner then performed its own analysis of the taxable charges included in the overall AT&T charges. Petitioner's calculation was accepted by the Division as the basis for determining the amount of tax due with respect to the AT&T charges.

When completed by the auditor, the pull reports were forwarded to EDP for summarization and analysis. The EDP statistical program generates several summary reports, including a listing of exception items, a summary of the statistical report and explanatory materials. These reports were prepared in this case and sent to petitioner for review. The following charts were prepared from the summaries prepared by EDP (Exhibit "X") and set forth partial results of the statistical sampling audit.

Expenses

Stratum Range	Stratum Size[5]	Sample Size	Dollar Value of Differences[6]	Mean[7]	Point Estimate[8]
(1) 00 - 99.99	257909	0	$ 0	0	$ 0
(2) 100 - 499.99	158624	350	242.32	.692343	109,822.22
(3) 500 - 999.99	37629	350	595.91	1.702600	64,067.14
(4) 1,000 - 2,499.99	19823	350	2,148.05	6.137286	121,659.42
(5) 2,500 - 4,999.99	8267	250	3,597.59	14.390360	118,965.11
(6) 5,000 - 7,499.99	3310	250	5,148.49	20.593960	68,166.01
(7) 7,500 - 9,999.99	1470	250	4,640.47	18.561880	27,285.96
(8) 10,000 - 19,999.99	2236	250	13,195.65	52.782600	118,021.89
(9) 20,000 - 99,999,999.99	1511	1511	173,517.98	114.836519	173,517.98
Credits	11645	250	0	0	0

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5 Also referred to as "population".

6 Total dollar value amount of additional tax due found by examination of the individual sample items.

7 Arithmetic average calculated by dividing the "Value of Differences" within a stratum by the sample size.

8 Estimated additional tax due calculated by multiplying the stratum size times the mean.

Totals	502,424	3,811	$203,086.46	1.595278[9]	$801,505.95

Assets

Stratum Range	Stratum Size	Sample Size	Dollar Value of Differences	Mean	Point Estimate
(1) 00 - 99.99	298	0	$ 0	0	$ 0
(2) 100 - 499.99	1357	0	0	0	0
(3) 500 - 999.99	1823	250	753.84	3.015360	5,497.00
(4) 1,000 - 2,499.99	2832	250	1,980.75	7.923000	22,437.94
(5) 2,500 - 4,999.99	1840	250	2,793.40	11.173600	20,559.42
(6) 5,000 - 7,499.99	818	250	5,128.31	20.513240	16,779.83
(7) 7,500 - 9,999.99	483	483	14,637.50	30.305383	14,637.50

[9] A weighted average.

(8) 10,000 - 19,999.99	630	630	21,071.85	33.447381	21,071.85
(9) 20,000 - 99,999,999.99	766	766	179,639.25	234.51992	179,639.25
Credits	203	203	0	0	0
Totals	11,050	3,082	$226,004.90	25.395728	$280,622.79

EDP determined that the overall relative sampling error in the expenses category was 13.6760%, and in the assets category, it was 5.0016%. The Division subtracted $109,614.24 and $14,035.52 from the point estimates on expenses and assets, respectively, to account for this sampling error. These dollar value amounts are referred to as the "precision factor". In this way, the Division estimated additional tax due on expenses of $691,891.71 and additional tax due in the area of assets of $266,587.27.

The parties stipulated to the following facts:

> "The...Division determined taxes claimed to be due in this matter at the 95% confidence level, with a one-sided test, and assessing at the lower end. In statistics 'confidence' describes a degree of certainty that an amount determined from analysis of a random sample plus or minus the 'precision' would actually include the 'true' result. When the 'confidence level' is 90%, 90 samples out of 100 samples of the same size from the same 'universe' would include within the 'precision' range the 'true' result which would be obtained if all items in the 'universe' were examined and the examination was free of transcription inaccuracies or other human error. A two-sided confidence level for a result indicates that result value with a range plus or minus the 'precision' amount. A 90 percent two-sided confidence is equivalent to a 95 percent one-sided confidence. A 95 percent one-sided confidence at the lower limit of the precision range indicates that the true result may be higher than the result from a given sample for 95 percent of samples of the same size and may be lower for 5 percent of samples of the same size." (Stipulation ¶ 11[F][15].)

The 95% confidence level achieved on this audit allows the Division to predict that there is a 95% probability that the amount of tax determined on audit is less than the amount actually due and a 5% probability that the amount of tax determined on audit is more than the amount actually due.

The month of April 1984 did not appear on the magnetic tapes provided to EDP. Consequently, the Division reviewed in detail all of petitioner's April 1984 accounts payable transactions recorded in the specific expense and asset accounts selected for audit, within stratum 9 for expense accounts and strata 7, 8, and 9 for asset accounts. From this examination, the Division determined additional tax due for April 1984 of $2,440.13 in the area of expense

purchases and $3,685.94 in the area of asset purchases. These are exact amounts not obtained by statistical sampling or any other method of estimating tax due. The Division estimated additional tax due of $16,860.83 based on the results of the statistical sampling audit for this period. Total tax due in April 1984 was determined to be $22,986.90.

An audit closing conference was held at petitioner's offices on February 1, 1988. At that conference, petitioner's representatives expressed some concerns about the use of account distributions, rather than invoices, as the sample unit. Petitioner offered several alternative calculations of tax due based on invoice amounts, but these alternatives were rejected by the Division as not statistically valid.

Challenges to the Audit

In reviewing credit transactions, the auditor did not treat any credit as an exception item unless the corresponding debit transaction was included in the sample items. He based this approach on his experience with other audits. This was an incorrect method of accounting for credit transactions in a statistical sampling audit, and it was not discovered during the course of the audit or as a result of audit conferences with petitioner conducted before the assessment was issued. The auditor examined 203 credit transactions in the asset universe and 250 in the expense universe. All of these were found to be no change or nonexception items.

Because the statistical sampling method treats all transactions within the universe population as included in the audit, any credit transaction in which petitioner received credit for an item other than the correct amount of tax, should have been noted as an exception item. One credit transaction in this audit serves to demonstrate the proper treatment of credit transactions in a statistical sampling audit.

A credit memo from John W. Harland and Co. shows delivery of merchandise in Erie County, which imposes sales tax at the rate of 7%. The credit memo shows the cancellation of a sale in the amount of $15.00 with a tax of $1.00. The correct amount of tax was $1.05. Although this particular sale was not included in the expense items sampled, statistical principles would state that the underpayment of $0.05 was picked up on the debit transaction;

therefore, the auditor should have increased the amount of the credit by the amount of the error, $0.05.

Petitioner identified four credit transactions in the audit sample which should have been treated as exception items.

(a) An invoice from Mandas & Orr shows a charge to petitioner of $2,800.00 for the installation of an ATM enclosure. No sales tax was charged. Petitioner issued one check to pay the invoice and then issued an internal credit to cancel the check. Petitioner then issued a new check to pay the $2,800.00 due the vendor. Petitioner's internal credit in the amount of $2,800.00 was included in the pull report of asset purchases to be reviewed in detail. The auditor treated the transaction as a nonexception item, with no change in the amount of tax due. The credit transaction should have been treated as an exception item, entitling petitioner to a credit in the amount of the tax due.

(b) A credit memo from Action Data Systems to petitioner indicates that it is crediting petitioner for one "PC Focus" shipped to petitioner in New York City. The total amount credited is $1,369.25, which includes (in addition to a miscellaneous charge of $5.00) a credit of $89.25 representing a 7% sales tax on a credit of $1,275.00. The auditor treated the transaction as a nonexception item. Because the item was shipped to New York City, the correct tax rate was 8.25%. Thus, this credit transaction should have been treated as an exception item, entitling petitioner to a credit in an amount correcting the tax charged.

(c) A credit invoice from Computerland indicates that it was issued to credit a sales invoice for an item that was to have been delivered to petitioner in New York City. The total amount credited is $1,177.00 which includes a charge of $1,100.00 and sales tax of $77.00. The sales tax rate imposed is 7%. Since the item was to be delivered in New York City, the correct rate was 8.25%. The auditor treated the credit transaction as a nonexception item. It should have been treated as an exception item correcting the amount of tax charged.

(d) A credit invoice from New Jersey Office Supply to petitioner indicates that petitioner was being credited for charges for a file transfer. The item was delivered to petitioner in New

York City and tax should have been charged at the rate of 8.25%. The total amount credited to petitioner on the credit invoice is $180.69 which includes a credit of $12.21 for sales tax (indicating a tax rate of 7.25%). The auditor treated this credit transaction as a nonexception item. It should have been treated as an exception item, entitling petitioner to an additional credit for the amount of the undercredited tax.

Norman Ayers, a data processing systems analyst in EDP, testified that the audit results should be adjusted to rectify errors made with regard to credit transactions. The Division appended to its brief two alternative methodologies for treating the error. They are included in Appendix A of this determination. There is no basis in the record for preferring one alternative over the other, and the Division has not argued in favor of either alternative.

After total additional tax due for an audit period is calculated, it is necessary to allocate the total to quarterly sales tax periods. This allocation will affect the amount of penalty and interest owed by the taxpayer. At the requst of auditors in the field, EDP developed a formula for allocating the tax to quarters. At hearing, Mr. Ayers was unable to recall the methodology used to allocate the tax amount but later obtained the information from other persons in his office. The formula used by the Division was described as follows: additional tax due per quarter for sampled stratas is divided by total additional tax due for the audit period in sampled stratas and multiplied by projected tax due for sampled stratas minus precision. It is petitioner's position that this "is not an accurate method of allocating the estimated tax because it allocates an extrapolated tax based on the ratio of unextrapolated tax, [and i]t would be more accurate to base the allocation on the extrapolated tax within a quarter" (Petitioner's Brief at 49, emphasis in original).

The issues raised with respect to the Division's treatment of the credit transactions and the allocation of tax to quarters were not raised by petitioner during the course of the audit. Petitioner first became aware that the Division's treatment of these aspects of the audit might be erroneous after speaking to a consultant hired by petitioner's representatives in preparation for hearing.

Petitioner pointed to one debit transaction which it believes was treated erroneously by the auditor. An invoice from Angiers Business Machines, Inc. indicates that the vendor charged petitioner for three typewriters delivered to petitioner in Charlotte, North Carolina. The amount of the charge was $1,385.76 which includes sales tax of $101.76. Since the typewriters were delivered out of State it appears that no sales tax was due. The auditor included this item in the statistical sampling as a nonexception item with no change in tax due.

Agreed Upon Adjustments

Prior to the hearing in this matter, petitioner and the Division agreed to adjust the amount of tax determined to be due by treating as nonexception items certain transactions that the Division had formerly included in the statistical sampling data as exception items:

(a) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to two invoices from B. Angell & Associates, Inc. ("Angell") to petitioner charging petitioner for marketing surveys. At petitioner's request, Angell performed a study of New York consumer reactions to various bank premiums as promotions and a study of New York State customers' financial delivery habits. The studies were performed only for petitioner, were conducted as a result of petitioner's request for the information and Angell was not entitled to share the results of the studies with others. Petitioner and the Division have agreed that the charges for these studies constitute a personalized or individual information service excluded from sales tax under Tax Law § 1105(c)(1) and have agreed to adjust the tax determined to be due by treating these two transactions as nonexception items, not subject to additional tax due.

(b) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to an invoice from Digi Link Co. ("Digi Link") to petitioner. After the issuance of the notice of determination, petitioner provided additional information demonstrating that petitioner accrued and paid New York use tax in the amount of $754.88 with respect to the Digi Link invoice. Petitioner and the Division have agreed to adjust the tax determined to be due by treating this transaction as a nonexception item, not subject to additional tax due.

(c) Petitioner and the Division agreed to adjust the amount of tax determined to be due

with respect to an invoice from Industrial Valley Bank ("IVB") to petitioner. Petitioner had developed a computer software program, called Trendfinder, and asked IVB to be a test site for the use of the program. Petitioner agreed to reimburse IVB for computer hardware which IVB purchased for use with the program. The invoice from IVB to petitioner is the bill for such reimbursement. The computer hardware was purchased and delivered to IVB in Pennsylvania. Although petitioner reimbursed IVB for the hardware, the hardware remains in Pennsylvania in the possession of IVB (now Fidelity Bank). Petitioner and the Division have agreed to adjust the tax determined to be due by treating this transaction as a nonexception item, not subject to additional tax due.

(d) Petitioner and the Division agreed to adjust the amount of tax determined to be due with respect to an invoice from Brennan Bros. Co., Inc. ("Brennan Bros.") to petitioner. Brennan Bros. was charging petitioner for material and labor to replace 35 to 40 feet of a 4-inch diameter sewer pipe from the front of petitioner's branch office in Wappinger Falls, New York to the street. The invoice includes a written request to "Please Forward Certificate of Capitol [sic] Improvement". The Division included this transaction in the statistical sampling data as an exception, subject to additional tax due. Petitioner and the Division have agreed to adjust the tax determined to be due by treating this transaction as a nonexception item, not subject to additional tax due.

Petitioner and the Division agreed to adjust the amount of penalty at issue with respect to the tax on amounts New York Telephone charged petitioner for certain private lines and other intrastate telephone services and on the amount which American Bell charged petitioner for "INST WIRE - FIRM BID". The Division originally included these transactions in the statistical sampling data as exceptions, subject to additional tax due and also included the transactions as exceptions for the purpose of computing the penalty, including interest at the penalty rate. Petitioner and the Division have agreed to treat this item as a nonexception item, not subject to additional tax due for the purpose of computing the penalty imposed on any additional tax determined to be due, and otherwise as an exception item, subject to additional

tax due.

The Division assessed additional tax in the amount of $1,798.27 with respect to charges collected by petitioner's landlord for the operation of a Cardox system and for materials and overtime labor for the operation of the heating, ventilation and air conditioning ("HVAC") system at Marine Midland Center in Buffalo. Petitioner's landlord controlled and operated the Cardox system and charged petitioner for its operation. Under the terms of the lease between petitioner and its landlord, the landlord is required to furnish petitioner with "space heating and cooling as normal seasonal changes may require to provide reasonable comfortable space temperature and ventilation for occupants of the Premises under normal business operation, daily from 8:00 a.m. to 6:00 p.m. (Saturdays to 1:00 p.m.), Sundays and holidays excepted." Under the terms of the lease, petitioner is required to pay the landlord if it requires "air conditioning (during the air conditioning season) or heating or ventilation during any season outside the hours and days" described above. Petitioner and the Division agreed to treat charges from petitioner's landlord for the operation of a Cardox system and for materials and overtime labor for the HVAC system as follows:

(a) as nonexception items, not subject to additional tax due, if Debovoise & Plimpton, the plaintiff in a declaratory judgment action against the Department, Debovoise & Plimpton v. New York State Department of Taxation and Finance (565 NYS2d 973 [Sup Ct NY County 1991]) (the "Action"), is successful in obtaining a final judicial determination that overtime HVAC services incidental to the provision of rented premises are not subject to sales tax;

(b) as exception items, subject to additional tax due, if Debovoise & Plimpton is not successful in obtaining such a determination; and

(c) in either event, as nonexception items, not subject to additional tax due, for the purpose of computing the penalty (including interest at the penalty rate) imposed on petitioner on any tax determined to be due.

For the purposes of the stipulation between petitioner and the Division, a "final judicial

determination" means a decision of a New York court having jurisdiction over the Action and whose decision is not subject to appeal to another New York State court; or, if subject to such appeal, has not been appealed within the time required for an appeal; or, if appealed, such appeal has been dismissed.

The Division originally included these transactions in the statistical sampling data as exceptions, subject to additional tax due and as exceptions for the purpose of computing the penalty, including interest at the penalty rate.

Penalty Items in Dispute

Prior to the hearing in this matter, petitioner and the Division stipulated to certain facts with respect to transactions which the Division treated as exceptions subject to additional tax due and as exceptions for the purpose of computing penalty, including interest at the penalty rate. Petitioner agrees to the treatment of these transactions as exception items, subject to additional tax due. Petitioner seeks abatement of penalty on each of the following items and seeks to have each of the items treated as nonexception items for the purpose of computing penalty, including interest at the penalty rate.

(a) Certain invoices reviewed by the Division were for information services, such as consumer surveys, credit reports and computer software, and advertising-related services.[10] The consumer survey information which each vendor sold to petitioner was obtained from a common data base from which the vendor could provide information to its other customers. The invoices for advertising-related services include charges for the production of employee training materials, including videotapes, training books and

quizzes, used exclusively for training petitioner's personnel. One of the invoices from Product Knowledge Associates was for the creation of a Student Money Book which was designed to solicit student business and provide students with information regarding money management

[10]A list of the invoices actually reviewed by the Division was submitted in evidence as Exhibit 3-G. The list does not show the type of service or merchandise actually purchased.

and other related topics. Petitioner initially treated the transactions in question as charges for personal information and advertising services which are exempt from sales tax but has since conceded that the charges were for taxable services. Petitioner agrees with the treatment of these transactions as exception items, subject to additional tax due, but disagrees with the treatment of these transactions as exception items for the purpose of computing penalty.

Petitioner did not believe these charges were subject to tax because it believed, upon initial review, that the services purchased were in the nature of personal information services which were not taxable, or were creative-type advertising services as opposed to services resulting in the production of tangible personal property. Accordingly, petitioner believed the transactions were not subject to tax. Petitioner states that the sales tax treatment of information services is a confusing area of law and believes that such confusion was the cause of the error.

(b) On certain vendor invoices listed in Exhibit 3-J or on accompanying papers, petitioner paid no sales tax because, at the time of purchase, it believed that the work performed by the vendor constituted a capital improvement. Petitioner has since conceded that such work did not constitute capital improvements. Petitioner agrees with the treatment of these transactions as exception items, subject to additional tax due, but seeks abatement of penalty and requests that they be treated as nonexception items for purposes of calculating penalty due.

Each of the vendor invoices in question includes the statement "capital improvement", "CI", or a request that a capital improvement certificate be returned to the vendor. It is not apparent from the face of any of the invoices that the work done was not a capital improvement. Petitioner was confused about the distinction between a capital improvement and a taxable repair or maintenance. For example, the Division treats the installation of coax cable between floors as a capital improvement, exempt from sales tax, but treats the installation of coax cable within a particular floor as taxable. Since petitioner found the area confusing, it relied on the contractor to properly determine whether the transaction was a capital improvement.

(c) Vendor invoices (copies of which are included in Exhibit 3-K) were actually reviewed by the Division as part of the audit. These were primarily charges by Reuters Limited

for what appear to be financial information services. On each invoice, the vendor charged sales tax on a portion of the amount it charged petitioner for property or services, but not on the total amount. Petitioner initially treated the amounts for which the vendor did not charge sales tax as exempt from sales and use tax but has since conceded that such amounts are subject to sales and use tax. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty (including interest at the penalty rate). Petitioner asserts that it reasonably relied on its vendors to determine the taxable status of the items sold by the vendors. In light of the fact that these vendors collected tax on a portion of the charges set forth on the invoices, petitioner believed that the vendors had a basis for determining that some, but not all, of the charges were exempt from tax.

(d) In 1985, the sales and use tax rate in Erie County, New York increased from 3% to 4%. On the invoices listed on Exhibit 3-L, the vendor charged petitioner, and petitioner paid, the former New York State and Erie County combined sales tax rate of 7% instead of the 8% rate which should have been charged and paid. The Division included these transactions in the statistical sampling data as exceptions, subject to additional tax due and as exceptions for the purpose of computing the penalty, including interest at the penalty rate. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty. The change in the Erie County sales tax rate took effect very quickly, within one or two weeks of when the rate increase was authorized. Given the short time period within which the change became effective, petitioner believes the failure of its accounts payable system to account for the change was reasonable.

(e) The invoices listed on Exhibit 3-N were reviewed by the Division and were from vendors charging petitioner for the installation of coax cable. The Division assessed tax on amounts which petitioner paid for the installation of coax cable on a particular floor but did not assess tax on amounts which petitioner paid for the installation of coax cable between floors. Petitioner initially treated the installation of coax cable on a particular floor as a capital improvement but has since conceded that such installation is not a capital improvement.

Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty (including interest at the penalty rate). Coax cable is installed in channels that run underneath the floor and is used to connect computer terminals and personal computers to other data processing equipment. Petitioner did not pay sales and use tax with respect to the installation of the coax cable because it viewed the installation as a permanent installation that would be left undisturbed.

(f) The invoices listed on Exhibit 3-O were reviewed by the Division and were from vendors to petitioner for the installation of ATM enclosures. Petitioner initially treated the installation of such enclosures as capital improvements but has since conceded that the enclosures are not capital improvements. In many cases, the vendor indicated that the work done constituted a capital improvement. Petitioner disagrees with the treatment of these transactions as exception items for the purpose of computing the penalty (including interest at the penalty rate). ATM enclosures are aluminum and glass or plexiglass enclosures erected to protect customers from rain and to provide some degree of security. Some of them include devices which allow a customer to gain access to the ATM enclosure by inserting a card with a magnetic strip. The enclosures are bolted to the ground and they generally appear to be a part of the building. Petitioner did not pay sales or use tax with respect to the installation of ATM enclosures because it believed that the enclosures were capital improvements.

(g) The Division reviewed the invoices listed on Exhibit 3-P on which the vendor charged petitioner for the installation of bandit barriers. A bandit barrier is a board, usually made of plastic or plexiglass, which is installed vertically over a bank teller counter to protect bank tellers. Petitioner initially treated the installation of bandit barriers as capital improvements because of their permanent nature and because they would not normally be disturbed. Petitioner concedes that the installation of the bandit barriers did not constitute capital improvements, but disagrees with the treatment of these transactions as exception items for the purpose of computing penalty.

(h) The invoices, copies of which are included in Exhibit 3-Q, were actually reviewed by

the Division as part of its audit of petitioner. They are charges from petitioner's landlord for various services, such as repair of doors, light bulb replacement, refurnishing chillers, providing an engineer to control the air conditioning system in petitioner's computer room and making and installing signs and shelves. Petitioner initially treated the charges as additional rent under a lease of real property and not subject to sales tax but has since conceded that such charges are subject to sales tax. Because it was the landlord's responsibility for performing work, such as repairing doors, replacing light bulbs and installing signs and shelves, as contained in the lease agreement, petitioner believes that it was reasonable to conclude that the charges for such work constituted additional rent payments under a lease of real property and were not subject to sales and use tax.

(i) One of the invoices reviewed by the Division was an invoice from VISA U.S.A. Inc. ("VISA") to petitioner for credit card terminals. The invoice was the first invoice petitioner received from VISA for credit card terminals. Petitioner disagrees with the treatment of this transaction as an exception item for the purpose of computing the penalty (including interest at the penalty rate), but otherwise agrees to the treatment of this transaction as an exception item.

Petitioner's accounts payable function is divided into groups with a number of clerks and a supervisor in each group. The supervisors report to the manager of accounts payable. The manager of accounts payable has publications of the Department of Taxation and Finance available to him to determine whether an item is subject to sales tax. Petitioner has its own reference manual which is used to determine the taxability of specific items. If the manager of accounts payable has questions about the proper application of the Tax Law, he reviews them with petitioner's tax manager.

CONCLUSIONS OF LAW

A. Pursuant to Tax Law § 1138(a)(2), whenever the tax determined under section 1138 is estimated, the notice of determination must "contain a statement in bold face type conspicuously placed on such notice advising the taxpayer: that the amount of the tax was estimated" (Tax Law § 1138[a][2]; emphasis added). Petitioner asserts that the notice of

determination issued by the Division is jurisdictionally defective and invalid because it failed to contain such a statement. The Division and petitioner agree that a statistical sampling methodology produces an estimate of tax due. The Division takes the position that the requirement of section 1138(a)(2) applies only to estimates of tax based on external indices and not to estimates based on statistical methodologies. In the alternative, the Division argues that, even if the notice ought to have included a statement that the tax resulted from an estimate, the absence of such a statement does not render the notice invalid.

The issue raised by petitioner was recently decided by the Tax Appeals Tribunal in Matter of A & J Parking (Tax Appeals Tribunal, April 9, 1992), where the Tribunal held that the omission of a statement indicating that the tax was estimated does not invalidate an otherwise proper notice, in the absence of proof that the taxpayer was actually prejudiced by the omission. The evidence establishes that petitioner was not so prejudiced. Petitioner was advised of the audit methodology to be used and provided with copies of the audit plan and workpapers (the summary reports, pull reports, summaries of tax due, etc.). Petitioner's employees actively participated in the audit by providing the auditor with invoices and other supporting documentation. Petitioner was given an opportunity to address the proper tax status of each of the exception items and to provide proof of nontaxability. Petitioner's representatives were given an opportunity before the issuance of the notice to meet with the Division to present any evidence or legal argument they might have which would change the audit results. Since the failure to indicate that the tax was estimated was remedied by the constant communication between the Division and petitioner during the course of the audit, the notice of determination is not invalid.

B. Tax Law § 1138(a)(1) provides, in pertinent part:

> "If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices, such as stock on hand, purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service, number of employees or other factors."

This provision has been construed by the Appellate Division, Third Department, as precluding audit methodologies based on a test period unless the taxpayer's records are inadequate to permit a complete audit. (Matter of James G. Kennedy & Co. v. Chu, 125 AD2d 773, 509 NYS2d 199; Matter of Hard Face Welding and Machine Co. v. State Tax Commn., 81 AD2d 967, 439 NYS2d 744; Matter of Names in the News v. State Tax Commn., 75 AD2d 145, 429 NYS2d 755, 756; Matter of Chartair v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41).

In Matter of Chartair v. State Tax Commn. (supra), the court stated:

> "Although there is statutory authority for the use of a 'test period' to determine the amount of tax due when a filed return is incorrect or insufficient (Tax Law § 1138, subd. [a]), resort to this method of computing tax liability must be founded upon an insufficiency of record keeping which makes it virtually impossible to verify taxable sales receipts and conduct a complete audit (citations omitted). However, if records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent become arbitrary and capricious and lack a rational basis (citation omitted)." (Id., 411 NYS2d at 43).

Because the statutory authority to determine a taxpayer's sales tax liability by estimate procedures rests upon a finding that the taxpayer's books and records are inadequate to conduct a complete audit, the Division is required to first request (Matter of Christ Cella v. State Tax Commn., 102 AD2d 352, 477 NYS2d 858, 859) and thoroughly examine (Matter of King Crab Rest. v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978, 979-980) the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, 828, lv denied 71 NY2d 806, 530 NYS2d 109), in order to determine from verification drawn independently from within these records whether they are sufficient to support a complete audit (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, 76, lv denied 44 NY2d 645, 406 NYS2d 1025). If the Division's examination establishes that the taxpayer's records are adequate and complete, the taxpayer is entitled to have its assessment calculated based upon a detailed audit of those records (Matter of James G. Kennedy & Co. v. Chu, supra; Matter of Allied New York Services v. Tully, 83 AD2d 727, 442 NYS2d 624; Matter of Names in the News v. State Tax Commn., supra; Matter of Chartair v. State Tax Commn., supra).

A petitioner challenging a validly issued notice of determination bears the burden of demonstrating error in either the audit method or audit results (Matter of A & J Gifts Shop v. Chu, 145 AD2d 877, 536 NYS2d 209, lv denied 74 NY2d 603, 542 NYS2d 518). Where the petitioner carries this burden by showing the audit method adopted by the Commissioner of Taxation and Finance ("Commissioner") lacks a rational basis, the petitioner need not prove the exact amount of the overassessment (e.g., Matter of Adamides v. Chu, supra [where a portion of the assessment was cancelled because the Division did not request records for that period of the audit]; Matter of King Crab Rest. v. State Tax Commn., supra [where the court cancelled an entire assessment on the ground that the auditor had not made a sufficient investigation of the records to justify his conclusion that the records were inadequate to support a complete audit]; Matter of Mohawk Airlines v. Tully, 75 AD2d 249, 429 NYS2d 759 [where the court held that in the face of complete and adequate records the use of estimating procedures to calculate the assessment is arbitrary and capricious]; see also, Matter of Nina Spallina, Tax Appeals Tribunal, February 27, 1992 [where the Tribunal stated that a taxpayer who demonstrates a fundamental error in the audit methodology has carried her burden of proof and need not prove the exact amount of the overassessment]). Under the rule first enunciated in Chartair, a taxpayer may prove that an audit method was not "reasonably calculated to reflect the tax due" (Matter of W.T. Grant v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert den 355 US 869) by showing that records were made available from which the exact amount of tax could have been determined and the Division nonetheless resorted to an indirect audit method (Matter of Chartair v. State Tax Commn., supra, 411 NYS2d at 43).

C. The Division and petitioner agree on certain basic facts: they have stipulated that the books and records for the audit period are adequate, sufficient and substantially complete and were available for examination by the Division at the time of the audit; the Division concedes that a statistical sampling audit produces an estimate of tax due; and petitioner agrees with the Division that a statistical sampling audit does not involve the use of an external index within the meaning of Tax Law § 1138(a)(1). Based upon these facts and the Third Department's

construction of Tax Law § 1138(a)(1) in Chartair and the cases following it, petitioner claims that the Division was without statutory authority to employ a statistical sampling audit methodology or any other methodology other than a detailed audit of the actual records. If petitioner's position is correct, the accuracy or reasonableness of the audit performed is not a question that need be reached, since only one audit method was statutorily authorized and that method concededly was not used.

The Division contends that the Third Department's construction of Tax Law § 1138(a)(1) is erroneous and in conflict with the Court of Appeals decision in Matter of W.T. Grant v. Joseph (supra). Based primarily on that decision, the Division maintains that it is within the statutory authority of the Commissioner to determine tax due on the basis of any reasonable audit method. In the Division's opinion, the existence of adequate books and records does not preclude the use of an estimating procedure. It only requires that the audit method fairly represent the taxpayer's actual business operations. It is the Division's position that in this case petitioner bears the burden of showing that the statistical sampling audit method used was not "reasonably calculated to reflect the tax due" (id., 159 NYS2d at 157) and that in the absence of such proof the audit must be sustained. The Division contends that petitioner can carry its burden by showing an error in the statistical sampling methodology (for instance, the consistent error in treating credit transactions) or by proving the exact amount of the overassessment (by demonstrating errors in the treatment of individual sample items) but cannot overcome the entire assessment by establishing the adequacy of its own books and records.

As petitioner's representatives note in their brief, Matter of Chartair v. State Tax Commn. (supra) is a binding precedent in this forum. In Matter of Mercy Hospital of Watertown v. New York State Department of Social Services (__ NY2d __, slip op., February 20, 1992), the Court of Appeals accepted the use of statistical sampling in Medicaid audits without regard to the adequacy or availability of the provider's records, rejecting the Third Department's reliance by analogy on the Chartair doctrine. Referring to this opinion, the Division's representative states: "[The Court of Appeals], footnote 5 at page 11, seems to suggest that the Chartair decision does

not conform to standards for audit methodology stated by the Court of Appeals in dicta in Grant v. Joseph". Apparently, the Division believes that the Court of Appeals decision in Mercy Hospital affords the Division of Tax Appeals the opportunity to reconsider the validity of the Third Department's construction of 1138(a)(1). I disagree. The Chartair doctrine has been affirmed repeatedly by the Third Department and never overturned by the Court of Appeals. The opinion in Mercy Hospital states: "This Court has not passed on the validity of the Third Department's construction of Tax Law § 1138(a) and we do not do so now" (Matter of Mercy Hospital of Watertown v. New York State Department of Social Services, id. at 11). Both the Division of Taxation and the Division of Tax Appeals are bound by the doctrine of stare decisis to follow the Third Department's decision in Matter of Chartair v. State Tax Commn. (supra) and the numerous cases which follow it. Accordingly, the only issue to be decided here is whether, under the Chartair doctrine, the Division is authorized to conduct a statistical sampling audit where the taxpayer provides complete and adequate books and records for audit.

D. Petitioner claims that there is no substantive difference between a statistical sampling methodology and a test period audit. In addition, it identifies certain characteristics of a statistical sampling audit which it argues should preclude its use where the taxpayer has complete records.

Petitioner notes that a statistical sampling audit is an estimating procedure just as a test period audit is. The statistical procedures used by the Division ensured that there was no more than a 5% chance that the Division had overestimated the tax due. Petitioner argues that it had a right to expect a detailed audit which would determine the exact amount of tax due, rather than an estimated amount, no matter how accurate the estimate. Petitioner points out that over one-half of the tax determined to be due was estimated based upon an extrapolation from the items that were actually reviewed. Thus, the estimated tax was a significant amount in relation to that determined from a review of the records.

Petitioner contends that the statistical sampling methodology is complex and confusing and not readily understood by those without specific training in the field. Here, petitioner hired

a consultant in statistical sampling who identified what petitioner claims were two errors in the methodology employed by the Division: (1) the treatment of credit transactions and (2) the allocation of tax to quarterly periods.[11]

It argues that the conscientious taxpayer who maintains complete and verifiable records should not be made to incur the additional expense of hiring an expert to attack the statistical sampling methodology.

The Division agrees that "the sufficiency of an audit methodology is directly related to the adequacy and accuracy of the records which are being reviewed" (Division's Brief at 76), but, citing to Matter of Meskouris Bros. v. Chu (139 AD2d 813, 526 NYS2d 679) and Matter of Yonkers Plumbing & Heating Supply Corp. v. Tully (62 AD2d 18, 403 NYS2d 792) as well as Chartair, it argues that even a taxpayer who maintains adequate and complete books and records is entitled, not to a detailed audit, but to an audit that is in accord with statistical norms. Alternatively, the Division claims that the statistical sampling audit method meets the test of Chartair because it uses the taxpayer's records in the audit and is, in effect, a detailed audit of the taxpayer's records. While the Division concedes that the mathematical and scientific foundations of the statistical sampling methodology are complex, it contends that the complexity of the methodology does not preclude its use.

E. From a mathematician's point of view, there may be a qualitative difference between a statistical sampling audit and a test period audit; however, the factors which may be persuasive to a mathematician are not necessarily of any legal significance under Chartair. Inasmuch as New York's courts have not considered whether the holding in Chartair prohibits the use of a

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[11]The Division concedes that the auditor's treatment of the credit transactions was inconsistent with the statistical sampling methodology developed by EDP, i.e., that the erroneous treatment resulted from human error, not an error in the program itself. The Division disputes petitioner's claim that the allocation formula was incorrect. The record establishes that the formula used to allocate tax to quarterly periods was not an integral part of the statistical sampling program. The formula was a method of estimating tax due in each quarterly period. It had no statistical validity, which is not to say that it was either highly inaccurate or unreasonable.

statistical sampling methodology where complete and adequate books and records are made available to the Division, the resolution of this issue necessitates an examination of the holding in Chartair, the cases that follow it and the reasoning upon which the cases are based.

Article 28 of the Tax Law imposes a series of legal duties and obligations upon vendors of tangible personal property and taxable services. Such vendors are under a duty to register with the Commissioner of Taxation and Finance (Tax Law § 1134), to collect the sales tax (Tax Law § 1132) and to maintain records of the receipts upon which the tax is imposed (Tax Law § 1135). Moreover, vendors are held personally liable for the tax required to be collected (Tax Law § 1133[a]), and customers are held liable for payment of tax directly to the Commissioner if the vendor fails to collect the tax at the time of the sale (Tax Law § 1133[b]). Under the authority of Tax Law § 1135, the Commissioner has promulgated regulations mandating the records which are to be kept by registered vendors (20 NYCRR 533.2). The failure to keep such records is deemed to establish the incorrectness of the filed sales tax returns under section 1138(a), thus authorizing the Commissioner to determine the tax due using any information available, including external indices if necessary (20 NYCRR 533.2[g]). The taxpayer who fails to maintain the statutorily required records bears a heavy burden of proof in attempting to overcome an assessment of tax, since it is well-established that "where the taxpayer's own failure to maintain proper records prevents exactness in determination of sales tax liability, exactness is not required" (Matter of Meyer v. State Tax Commn., supra, 402 NYS2d at 78). Based on this rule, the courts have sanctioned the use of cash register tapes from one day of business to estimate taxes for a three-year period (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454), the calculation of sales based upon an external factor of ten times the taxpayer's rent (A & J Gifts Shop v. Chu, supra) and the use of a two-day observation test to project daily sales for a three-year period (Matter of Vebol Edibles v. Tax Appeals Tribunal, 162 AD2d 765, 557 NYS2d 678).

The sales tax cases decided under the doctrine first enunciated in Chartair highlight the legal significance the courts attribute to the statutory duty to maintain books and records. In

Chartair, the court stated:

> "[i]f records are available from which the exact amount of tax can be determined, the estimate procedures adopted by the respondent [State Tax Commission] become arbitrary and capricious and lack a rational basis" (Matter of Chartair v. State Tax Commn., supra, 411 NYS2d at 43).

In Matter of Names in the News v. New York State Tax Commn. (supra), where the Division had access to petitioner's detailed records for the audit period, the court stated:

> "[u]nder these circumstances, the bureau's use of the test period to compute petitioner's tax liability was plainly unnecessary, arbitrary and capricious, and petitioners were entitled to have their tax assessment calculated based upon a detailed audit of their records for the three-year period under consideration" (id., 429 NYS2d at 756 [emphasis added]).

Likewise, the taxpayer in Matter of Allied New York Services v. Tully (supra) maintained records from which the tax due could be readily ascertained. The court held that "there was no insufficiency of record keeping to justify resort to estimates based upon invoices from a one-month test period", and again stated that petitioner was entitled to a detailed audit (id., 442 NYS2d at 626-627). In Matter of James G. Kennedy v. Chu (supra), the court stated:

> "Given the unquestioned availability and completeness of petitioners' books and records, respondents' reliance on estimation procedures to determine the tax due was indefensible" (id., 509 NYS2d at 201).

The statutory duty to maintain verifiable records of sales receipts has been used by the court to distinguish sales tax and income tax audit cases. In Matter of Hennekens v. State Tax Commn. (114 AD2d 599, 494 NYS2d 208), the petitioner maintained that an indirect audit method can be used to determine an income tax deficiency only where the taxpayer's books and records are demonstrably incomplete. In response to this argument, the court stated:

> "The obvious distinction between this case and the Chartair line of cases is the type of tax being imposed. Those cases seek recovery under Tax Law § 1138 for sales and use taxes imposed directly upon verifiable receipts evidenced by books and records, which vendors are required by statute to maintain (see, Matter of Licata v. Chu, 64 NY2d 873, 874, 487 NYS2d 522) whereas, in the case at bar, the tax is imposed upon income, the receipt of which cannot easily be verified by reference to books and records. In other words, Chartair depends upon the existence of verifiable records, not here present" (id., 494 NYS2d at 209).[12]

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[12] The Division argues in its brief that Hennekens and cases citing its reasoning (e.g., Matter of Giuliano v. Chu, 135 AD2d 893; 521 NYS2d 883) are wrongly decided. Hennekens is

These decisions contradict the Division's claim that the statistical sampling methodology employed to determine petitioner's tax liability meets the standard of Chartair. In each of the decisions cited, the court held that a taxpayer who satisfies the duty to maintain statutorily required records is entitled to a detailed audit. More importantly, where the evidence has established the existence of adequate books and records, the courts have not deemed it necessary to inquire into the reasonableness of the audit methodology or the accuracy of the results before cancelling the assessment (see, e.g., Matter of James G. Kennedy v. Chu, supra; Matter of Hard Face Welding v. State Tax Commn., supra; Matter of Names in the News v. State Tax Commn., supra). The operative principle underlying the Chartair line of cases is the right of the taxpayer to rely on his or her maintenance of statutorily required books and records to overcome an assessment. The statistical sampling methodology is in conflict with this principle because it severely impairs the taxpayer's ability to carry its burden of proof by reference to books and records which are concededly sufficient as a matter of law. This last point needs some elaboration.

Here, petitioner asserts two errors in the audit methodology. In general, those errors were associated with the statistical validity of the procedure followed by the Division. Petitioner claims, and the Division concedes, that the Division failed to follow its own procedures in its treatment of credit transactions. Petitioner also claims that the Division's method of allocating total tax due to quarterly periods is erroneous. In both instances, petitioner could not rely on its own books and records to carry its burden of proof. It could not point to an invoice or an entry in its records of account or its own unique business operations to show an error in the Division's audit methodology. With respect to the credit transactions, petitioner discovered the error with the help of a consultant hired to review the Division's procedures. After the hearing, the

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consistent with Chartair and it is a binding precedent in cases decided by the Division of Tax Appeals. Contrary to the Division's assertion, the Internal Revenue Code does not dictate the nature of records to be maintained by the taxpayer in the same detail as does the sales tax law (compare, Tax Law § 1135 with IRC §§ 441 et seq.).

Division offered two alternative formulas to adjust for the error, but absent expert testimony from both the Division and petitioner, I cannot determine whether either of the alternatives is fair or reasonable. In both instances, the amount of the adjustment is insignificant in comparison to the total amount of the assessment; however, because the alternative methods rest upon unproven assumptions, any adjustment made at this point in the proceedings would result in an estimated correction. The Division argues that petitioner had the burden of reviewing all of the credit transactions included in the sample and identifying those which should have been treated as exception items. Absent such proof, the Division claims that petitioner must be content with a reasonable estimate to adjust for the error.

Petitioner's position is that it did not address the treatment of the credit transactions merely to establish the amount of the overassessment. It asserts that the error demonstrates the complexity of the statistical sampling methodology and illustrates its claim that the methodology forces the taxpayer to go outside its own books and records to successfully challenge the Division's audit. Petitioner had, and has, the ability to locate each credit transaction in the statistical sample which should have been treated as an exception item, but it was only with the aid of an outside consultant that it was able to identify the "human error" in the treatment of the transactions.

As to the allocation question, the evidence establishes that the allocation formula was not a part of the statistical program developed by EDP, and the distribution of tax to quarterly periods does not have the statistical validity that can be attributed to the determination of total tax due for the audit period. A detailed audit of petitioner's records would have resulted in an assessment of tax liability in the quarterly period in which the liability arose. Since interest and penalty are to be determined in the same manner as tax (Tax Law § 1145[a][7]), it would seem that petitioner was entitled to such an audit method. This is especially true since the allocation of the tax to quarterly periods can greatly affect the amount of interest and penalty assessed.

As stated above, the basic principle of Chartair is that a taxpayer who maintains the statutorily required books and records "has a right to expect that they will be used in any audit

to determine his ultimate tax liability" (Matter of Chartair v. State Tax Commn., supra, 411 NYS2d at 43). The Division contends that the statistical sampling methodology satisfies this principle on two grounds. First, the Division asserts that the testimony of Dr. Roberts "establishes that a properly designed and conducted statistical sampling audit is in fact a review of all the items in the population" (Division's Brief at 89, emphasis added). In his testimony, Dr. Roberts stated: "Statistical sampling actually is a methodology that allows you to examine all items in a population by selecting just a few" (transcript at 235). In fact, only a sample of all items in the petitioner's accounts receivable records were actually reviewed by the auditor. As a matter of fact and law, a statistical sampling audit is not a detailed item-by-item audit of all items in the population. The Division also argues that the selection of sample items from all of the petitioner's records is a "use" of those items within the meaning of the sentence in Chartair quoted above. It is indisputable that the Division may not employ a test period audit where records are available from which a detailed audit can be conducted. The courts have not distinguished between a test period audit that employs an external index, such as a test period markup audit which uses a taxpayer's record of purchases to determine taxable sales, and one that is confined to the taxpayer's books and records. In Matter of Chartair v. State Tax Commn. (supra), the Division used a three-month test period audit of petitioner's sales records and not an external index (see also, Matter of James G. Kennedy & Co. v. Chu, supra). The question then is whether a statistical sampling methodology uses a taxpayer's records differently than a test period audit uses them.

The Division's witnesses pointed out that the primary difference between a test period audit and a statistical sampling audit is the statistical validity of the sample. The sample items upon which the test period is based are selected by the auditor from the taxpayer's records based upon his or her own judgment. The accuracy of the result is related to the representativeness of the period selected by the auditor. The statistical sampling audit selects sample items from the taxpayer's records by use of a computer-generated random number program. The accuracy of its result is related to the validity of the statistical sampling program (not in issue here), the

Division's adherence to the program's actual procedures, and the laws of chance and probability. The accuracy of a test period audit cannot be proven. The error in the statistical sampling audit is quantified in the precision factor. Both estimate the tax owed based upon a sub-set of all of the taxpayer's records. Both use the taxpayer's records to determine the amount of tax due.

The Division takes the position that the reasonableness of the audit methodology must be weighed against the condition of the taxpayer's records. Where the taxpayer's records are indisputably inadequate to verify taxable sales, the taxpayer must be satisfied with a less than precise methodology (see, Matter of Markowitz v. State Tax Commn., supra). Where the taxpayer's records are complete and adequate, as they are here, the Division contends that the taxpayer is entitled to an audit method that conforms to statistical norms. In support of its position the Division cites to Matter of Yonkers Plumbing & Heating v. Tully (62 AD2d 18, 403 NYS2d 792), where the court stated:

> "There is no inflexible rule that an item-by-item audit must be made whenever it is possible, but it should be utilized if records are available and the test-check method is insufficient to afford a reasonable calculation of the taxes due" (id., 403 NYS2d at 794).

In Yonkers the court determined that a one-month test check was not a fair and reasonable sample upon which to base a 58-month projection of tax, especially in light of the fact that the one-month figures included five large sales which might have skewed the result (id.). Yonkers was decided on April 6, 1978, several months before the Chartair decision (November 30, 1978). Since Chartair was decided, no court decision has validated a test-check audit method where the taxpayer made available adequate books and records. Furthermore, in cases decided since Yonkers, the courts have stated that a taxpayer who maintains adequate records is "entitled" to a detailed audit of those records (Matter of Names in the News v. New York State Tax Commn., supra, 429 NYS2d at 756; Matter of Allied New York Services v. Tully, supra, 442 NYS2d at 627). Finally, the decision in Yonkers did not affirm the test-check audit method employed in that case. Accordingly, the decision in Yonkers is not sufficient to support the Division's claim that a detailed audit is not required where there are adequate

records.[13]

Petitioner persuasively challenges the Division's claim that applying the Chartair doctrine to statistical sampling audits would "in effect insulate from a comprehensive audit any large entity whose records are voluminous" (Division's Brief at 87). Based on its review of the pull reports, petitioner determined that the Division found no tax due on items sampled in 68 of the 105 accounts reviewed as part of the audit of expense transactions. It also found that approximately 78% of the errors found in the expense category occurred in only nine accounts. Based on these figures, petitioner argues that the Division might have conducted a computer assisted audit, using smaller samples to identify those accounts which contained consistent errors, and then conducted a detailed audit of items in those accounts. Such a methodology would certainly be acceptable under Chartair. Petitioner suggested several other methods which might have allowed the Division to conduct a detailed audit in a reasonable amount of time. Without checking petitioner's calculations, I think it is safe to conclude that a determination precluding statistical sampling under the scenario that exists in this case would not insulate large scale vendors from audit. This audit involved the actual review by the auditor of 6,893 sample items. The actual amount of tax due based on this review was $429,091.36, plus penalty and interest (since adjusted by stipulation of the parties). In addition, as a result of the audit and

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[13]In its brief, the Division also quoted Matter of Meskouris Bros. v. Chu (supra, 526 NYS2d at 680-681) where the court stated:

> "Where the taxpayer's books and records are undeniably inadequate, the Tax Commission cannot be required to compute the tax owed with a high degree of precision or be held to ensure that the amount arrived at accords with statistical norms, for an accurate reckoning has been thwarted by the petitioner's failure to comply with the law regarding record keeping (citation omitted)."

Meskouris Bros. involved a taxpayer with undeniably inadequate records; therefore, the court's reference to statistical norms is mere dicta. The decision cannot be read as an endorsement of the use of statistical sampling where the taxpayer provides the auditor with all of the books and records required by statute.

an agreement that

allowed petitioner to calculate its own additional tax liability on AT&T charges, petitioner paid additional sales tax to the State of $343,977.81 plus interest of $94,666.49. In light of these figures, it is difficult to credit the Division's claim that requiring it to performed a detailed audit where adequate records are available would preclude it from auditing large scale vendors. Of course, a statistical sampling audit may always be used with the consent of the taxpayer.

Based upon the above discussion, I conclude that the Division's resort to a statistical sampling audit method in the face of complete and adequate books and records and without the consent of petitioner was not authorized by Tax Law § 1138(a)(1).

F. Petitioner did not provide audit files for the month of April 1984; therefore, the Division was entitled to estimate the tax due for that month, and the full amount assessed for April 1984 ($22,986.90) is sustained. That portion of the Division's assessment which is based on a detailed examination of petitioner's purchase records is sustained ($429,091.36 minus adjustments stipulated to by the parties; see, Findings of Fact "40" and "42"). The remainder is cancelled. Petitioner is granted a partial refund of tax, plus interest, the exact amount to be calculated by the Division.

G. Petitioner seeks abatement of penalty on certain transactions which were actually reviewed by the Division. The Division agreed to cancel the penalty on certain of those transactions which involved New York telephone charges for certain private lines and other intrastate telephone services (Finding of Fact "41") and charges by petitioner's landlord for operation of a Cardox and HVAC system (Finding of Fact "42"). Those penalties will be cancelled consistent with the stipulation of the parties.

H. Petitioner was assessed penalty under section 1145(a)(1)(i), (ii) of the Tax Law which provides for imposition of penalty and the calculation of interest at a specified rate whenever any person fails "to file a return or pay over any tax...within the time required by or pursuant to [article 28]". Section 1145(a)(1)(iii) allows for abatement of penalty where the petitioner has

established that such failure was due to reasonable cause and not due to willful neglect. The taxpayer bears the burden of establishing reasonable cause as well as the absence of willful neglect (see, e.g., Matter of T.V. Data, Inc., Tax Appeals Tribunal, March 2, 1989). In determining whether reasonable cause exists, the most important factor to consider is the extent of the taxpayer's efforts to ascertain its proper tax liability (see, Matter of Northern States Contracting Co., Inc., Tax Appeals Tribunal, February 6, 1992; see also, 20 NYCRR 536.5[d][1], [2]).

In several instances petitioner argues that its reliance on its vendors to properly charge and collect tax was reasonable and constitutes reasonable cause under Tax Law § 1145. Petitioner relied on its vendors to determine whether the installation of coax cable was a capital improvement or a charge for repair and installation of property. It claims that its reliance was reasonable, because the law is confusing with respect to whether certain services constitute capital improvements. Likewise, it relied on Reuters Limited to determine which of its services and sales were subject to tax. Because Reuters charged tax on some, but not all, charges, petitioner believed that the vendor had a basis for not collecting tax on the entire amount. In Matter of LT & B Realty v. State Tax Commn. (141 AD2d 185, 535 NYS2d 121, 123), the court held that reliance on the advice of a tax professional is not necessarily grounds to support a finding of reasonable cause because allowing consultation with a tax professional to act as an immunity to penalties would eviscerate the penalty provisions altogether (see also, Matter of Auerbach v. State Tax Commn., 142 AD2d 390, 536 NYS2d 557). The same principle governs here. Petitioner's duty to pay sales tax directly to the Commissioner was separate from its vendor's duty to collect and pay the tax (Tax Law § 1133[b]). Accordingly, petitioner had its own duty to ascertain its tax liability. Abatement of penalty based on reliance on a vendor would effectively shield petitioner from any penalty and relieve it of its own separate duty to determine the taxable status of the transactions it entered into. If the area of law was confusing with regard to any of these transactions, petitioner's efforts to ascertain its tax liability should have increased. Mere reliance on its vendors does not establish reasonable cause.

Petitioner claims that its failure to pay sales tax on its purchases of information services, training materials and other products was based on a genuine misunderstanding of the law (Finding of Fact "43[a]"). Those purchases are categorized in the Stipulation of Facts as "information services" and "advertising-related services" (Stipulation, ¶ 9-A). Petitioner asserts that during the audit period consumer surveys were considered to be excluded from sales tax under the holding of New York Life Insurance Co. v. State Tax Commn. (80 AD2d 675, 436 NYS2d 380, affd 55 NY2d 758), and that it was not until the courts narrowed the holding in that decision that reports prepared from a common database were deemed subject to tax (see, Matter of Rich Products v. Chu, 132 AD2d 175, 521 NYS2d 865; Matter of Towne-Oller Associates v. State Tax Commn., 120 AD2d 873, 502 NYS2d 544). Petitioner argues that it had reasonable cause with respect to the consumer surveys it purchased during the audit period because its conclusion that the surveys were excluded from tax was consistent with the then prevailing legal precedent. In order to prevail on this argument, it was incumbent upon petitioner to prove that the consumer surveys, credit reports and other information services it purchased were like the confidential character reports at issue in New York Life Insurance. Under the holding of that case, not all consumer surveys and credit reports were deemed to be excluded from sales tax but only those which furnish information "which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons" (Tax Law § 1105[c][1]). The description of the consumer surveys and credit reports purchased by petitioner is sketchy and vague. I cannot, on this record, find that petitioner reasonably relied on the then existing precedent with regard to its purchases of information services. Petitioner's claims with regard to its purchases of advertising related services do not establish reasonable cause. Most of these appear to be purchases of tangible personal property used for training employees and to distribute as promotional items. Petitioner cannot reasonably have believed that these were the purchases of the services of an advertising agency.

Petitioner claims that it reasonably concluded that the installation of coax cable on one

floor, the installation of ATM enclosures, and the installation of bandit barriers were capital improvements and, therefore, not subject to sales tax. Again, the test of good faith is the demonstrated effort of the taxpayer to ascertain its tax liability. Petitioner contends it had good reason to believe that all of these installations were capital improvements because of the seeming permanence of the installations. In order to show reasonable cause, it was incumbent upon petitioner to show the steps it took to determine whether the installations were capital improvements under section 1105(c) of the Tax Law. Petitioner has failed to shoulder this burden.

Petitioner claims that it was reasonable for it to believe that charges made by its landlord for maintenance and repair services were not subject to tax "because they were paid and incurred pursuant to a lease for the rental of real property" (Petitioner's Brief at 65). This contention is somewhat vague. Petitioner's landlord separately billed petitioner for the repair services. If they were paid and incurred under a lease for the rental of real property, it must have been in an indirect fashion. In any case, petitioner's erroneous belief does not establish reasonable cause.

Finally, I can give little credence to petitioner's claim that it took some time for its accounts payable system to catch up with the increase in the Erie County sales tax rate. Petitioner presented no evidence to show that it even attempted to identify or correct the errors made, and there is no evidence of how the change was communicated to its clerks.

I. The petition of Marine Midland Bank, N.A. is granted to the extent indicated in Conclusions of Law "E", "F", and "G"; the Notice of Determination and Demand for Payment of Sales and Use Taxes Due issued February 24, 1988 shall be modified accordingly; a refund

will be granted to the extent consistent with Conclusions of Law "F" and "G"; and in all other respects, the petition is denied.

DATED: Troy, New York
July 16, 1992

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE

APPENDIX A

AUDIT DATA
STIPULATED ADJUSTMENTS
AND THE CREDIT TRANSACTION ERROR

I. AUDIT DATA[14]

A. ASSETS

	UNIVERSE		SAMPLE		DIFFERENCES		POINT ESTIMATE
	Size	$ Value	Size	$ Value	Size	$ Value	OF DIFFERENCES
TOTAL POSITIVE	226,004.90	10,847 $280,622.79	92,291,469		2,879	77,410,940	183
CREDIT TRANS	203	-2,051,626	203	2,051,626	-0-	.00	-0-
TOTAL	11,050	90,239,843	3,082	75,359,313	183	226,004.90	280,622.79
					less precision		-14,035.52
					tax due		$266,587.27

B. EXPENSES

	UNIVERSE		SAMPLE		DIFFERENCES		POINT ESTIMATE
	Size	$ Value	Size	$ Value	Size	$ Value	OF DIFFERENCES
TOTAL POSITIVE	203,086.45	490,779 $801,505.91	275,340,574		3,561	89,123,700	205
CREDIT TRANS	11,645	- 6,154,078	250	- 141,781	-0-	.00	.00
TOTAL	502,424	269,186,495	3,811	88,981,918	205	203,086.45	801,505.95
					less precision		-109,614.24
					tax due		$691,891.71

C. AUDIT TOTALS

	UNIVERSE SIZE	UNIVERSE VALUE	SAMPLE SIZE	SAMPLE VALUE	SAMPLE DIFFERENCES	TAX DUE ON AUDIT
ASSETS	11,050	90,239,843	3,082	75,359,313	226,004.90	266,587.27
EXPENSES	502,424	269,186,495	3,811	88,981,918	203,086.45	691,891.71
TOTAL	513,474	359,426,338	6,893	164,341,231	429,091.35	948,478.98

[14] Source: Ex. C: WP-G, WP-11, WP-14, WP-15
Stip: Ex. X, Ex. W

II. STIPULATED ADJUSTMENTS

A. TRANSACTIONS AGREED NONTAXABLE

			Tax Amount
B. Angell	Stip ¶ 8-A	Stip Ex C	$ 2,100.00
DigiLink	Stip ¶ 8-C		754.88
IVB	Stip ¶ 8-D	(V #00256852)[15]	626.26
Brennan Bros.	Stip ¶ 8-E	Stip Ex E	915.11
		Group A Total	4,396.25

B. TRANSACTIONS AGREED TAXABLE, NOT SUBJECT TO PENALTY

N.Y. Tel. Co.	Stip ¶ 9-B	Stip Ex H	48,033.36
American Bell	Stip ¶ 9-C	Stip Ex I	236.74
		Group B Total	48,270.10

C. TRANSACTIONS AGREED NOT SUBJECT TO PENALTY
TAXABILITY TO BE RESOLVED BY OTHER LITIGATION

Landlord HVAC & Cardox	Stip ¶ 8-F	Stip Ex F	1,798.27
TOTAL DIVISION AGREES NOT SUBJECT TO PENALTY			54,464.62

D. TRANSACTIONS AGREED TAXABLE, PENALTY AT ISSUE

Information Services, Training Materials, Videos, Booklets	Stip ¶ 9-A	Stip Ex G	$ 74,476.91
Contractor Charges	Stip ¶ 9-D	Stip Ex J	88,067.44[16]
Supplier Cost of Tax	Stip ¶ 9-E	Stip Ex K	2,037.43
Erie Cty Rate Change	Stip ¶ 9-F	Stip Ex L	2,662.88
VISA Terminals	Stip ¶ 9-G	Stip Ex M	3,412.50
COAX Cable Installation	Stip ¶ 9-H	Stip Ex N	10,828.67[18]
ATM Enclosures	Stip ¶ 9-I	Stip Ex O	21,066.15[18]
Bandit Barriers	Stip ¶ 9-J	Stip Ex P	6,752.50[18]
Landlord Repairs and Maint.	Stip ¶ 9-K	Stip Ex Q	11,225.83
		TOTAL	$220,530.31

Group A Total	4,396.25
Group B Total	48,270.10
Group C Total	1,798.27
TOTAL STIPULATION	$274,894.93

[15]Voucher # from petitioner's account distribution records (Ex. D).

[16]Originally claimed exempt capital improvement, Total $126,714.76.

ANALYSIS OF STIPULATED ADJUSTMENTS

Group A, Agreed Nontaxable

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{4,396.25}{429,091.35} = 1.02\% \ [.0102]$$

Group B, Agreed Nontaxable, Not Subject to Penalty

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{48,270.10}{429,091.35} = 11.25\% \ [.1125]$$

Group C, Agreed Nonpenalty, Taxability to be Decided

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{1,798.27}{429,091.35} = .42\% \ [.0042]$$

Group D, Agreed Taxable, Penalty at Issue

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{220,530.31}{429,091.35} = 51.39\% \ [.5139]$$

Contractor Charges/Capital Improvements

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{126,714.76}{429,091.35} = 29.53\% \ [.2953]$$

$$\frac{\text{value in audit}}{\text{Stipulation Group D}} = \frac{126,714.76}{220,530.31} = 57.46\% \ [.5746]$$

Unexplained Audit Exception Items

Total Sample Exception Items	429,091.35
Total Sample Exception Items	-274,994.31
TOTAL UNEXPLAINED	$154,097.04

$$\frac{\text{value in audit}}{\text{total differences}} = \frac{154,097.04}{429,091.35} = 35.91\% \ [.3591]$$

III. ADJUSTMENT FOR CONSISTENT HUMAN ERROR ON CREDIT TRANSACTIONS

ALTERNATIVE I

Assuming all credit transactions occurred in an 8% rate locality and not any tax was shown on credit transactions which were actually taxable, the audit error on credit transactions can be corrected as shown below:

ASSETS

Positive Sample Differences / Positive Sample Size $\frac{183}{2,879} =$ 6.36% [.0636 error rate]

2,051,626 [Credit Sample Value] x .0636 = 130,483 x .08 [max tax rate] = $10,438.67 Credit Universe Value

[Credit Sample Value = Credit Universe Value]

EXPENSES

Positive Sample Differences / Positive Sample Size $\frac{205}{3,561} =$ 5.76% [.0576 error rate]

141,781 [Credit Sample Value] x .0576 = 8,166.54 x .08 [max tax rate] = 653.33 Credit Sample Error

6,154,078 [Credit Universe Value] x .0576 = 354,474.89 x .08 [max tax rate] = 28,357.99 Credit Universe Error

Credit Universe Error Assets 10,438.67
Credit Universe Error Expenses 28,357.91

38,796.58 TOTAL MAXIMUM CREDITS ADJUSTMENT

ALTERNATIVE II

Assuming credit transactions were distributed among local taxing jurisdictions in the same proportion as debit transactions, the overall tax rate reflected in debit transaction tax due will reflect the correct tax rate for the credit transactions:

Positive Sample Tax / Positive Sample Value x Credit Universe Value = Credit to be Allowed

ASSETS

$\frac{\$266,005}{\$77,410,940}$ [= .0029] x $2,051,626 = $ 5,949.76

EXPENSES

$\frac{\$203,086}{\$89,123,700}$ [= .0023] x 6,154,078 = $14,154.38

TOTAL MAXIMUM CREDIT ADJUSTMENT $20,104.14

COMPARISON OF CREDIT ADJUSTMENT AMOUNTS
TO THE NOTICE OF DETERMINATION

Magnitude of Credit Transactions = Credit Transactions Value / Total Population Value

Assets $\frac{2,051,626}{90,239,843} = 2.27\%$

Expenses $\frac{6,154,078}{269,186,495} = 2.29\%$

CREDIT ADJUSTMENT % OF NOTICE OF DETERMINATION

ALTERNATIVE I $\frac{38,796.58}{948,478.98} = 4.09\%$
CREDITS ADJUSTMENT

ALTERNATIVE II $\frac{20,104.14}{948,478.98} = 2.12\%$
CREDITS ADJUSTMENT