

JURISDICTION: OKLAHOMA TAX COMMISSION
CITE: 2006-12-07-04 (Non-Precedential)
ID: P-05-141-K
DATE: DECEMBER 7, 2006
DISPOSITION: SUSTAINED
TAX TYPE: SALES
APPEAL: NONE TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Oklahoma Tax Commission, having reviewed the facts and authorities presented and being fully advised in the premises, finds and orders that the Application for Oral Argument before the Oklahoma Tax Commission En Banc is hereby denied. Having reviewed the files and records herein, including the Findings of Fact, Conclusions of Law and Recommendations made and entered by the Administrative Law Judge on the 8th day of September, 2006, the Commission makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

A projection audit utilizing a “cost mark-up” (depletion) method was performed by the Division on Protestant’s sales records and the sales records of Protestant’s liquor, wine and beer wholesalers for the months of April and October, 2004. As a result of the audit, the Division determined that Protestant had additional taxable sales during the audit period of January 1, 2003 through December 31, 2004, and by letter dated August 22, 2005, proposed the assessment of sales tax, interest and penalty against Protestant. Protestant timely protested the proposed assessment by letter dated August 29, 2005.¹

On September 22, 2005, the protest was referred to the Office of the Administrative Law Judges (“ALJ’s Office”) for further proceedings consistent with the Uniform Tax Procedure Code² and the Rules of Practice and Procedure before the Oklahoma Tax Commission³. The protest was docketed as Case No. P-05-141-K and assigned to ALJ, Administrative Law Judge.⁴

A pre-hearing conference was scheduled for November 14, 2005, by Prehearing Conference Notice issued October 18, 2005.⁵ By Memorandum filed November 9, 2005, the parties submitted a Status Report In Lieu of Prehearing Conference wherein the parties requested additional time to submit a proposed scheduling order. By Memorandum filed December 23, 2005, the parties submitted a Proposed Scheduling Order. A Scheduling Order and Notice of Hearing was issued December 27, 2005, setting forth dates for exchanging discovery requests,

¹ Rule 710:1-5-22(a) of the *Oklahoma Administrative Code* (“OAC”).

² 68 O.S. 2001, § 201 et seq.

³ OAC, 710:1-5-20 through 710:1-5-47.

⁴ OAC, 710:1-5-22(b).

⁵ OAC, 710:1-5-28(a).

conducting discovery, exchanging final witness lists and documents, and filing factual stipulations and pre-trial briefs or position letters.⁶ The Order also scheduled the protest for hearing on March 23, 2006.⁷

A closed hearing⁸ was held as scheduled. Two witnesses, MANAGER, Protestant's store manager, and AUDIT SUPERVISOR, Division audit supervisor, testified. Division's Exhibits A through G were identified, offered and admitted into evidence without objection. Protestant's Exhibit 1 which consists of thirty-eight (38) documents was offered and admitted into evidence without objection. At the conclusion of the hearing the parties were directed to file proposed findings, conclusions and recommendations.⁹ Protestant's Proposed Findings, Conclusions and Recommendations and the Proposed Findings of Fact and Conclusions of Law of the Audit Division were filed on June 5, 2006, whereupon the record in this cause was closed and the case was submitted for decision.¹⁰

FINDINGS OF FACT

Upon review of the file and records, including the Transcript of the hearing, the exhibit received into evidence and the post-hearing submissions of the parties, the undersigned finds:

1. Protestant is the owner of and does business as LIQUOR STORE, a retail liquor store located in SUBURB, Oklahoma. Undisputed fact. See, the proposed findings of the parties.
2. Protestant operates his business under sales tax permit number 123456. Exhibit D.
3. Protestant's "gross receipts or sales" and "cost of goods sold" for 2003 were \$1,307,815.00 and \$1,145,557.00, respectively. Protestant's Exhibit 1, sub-exhibit 3.
4. Protestant's "gross receipts or sales" and "cost of goods sold" for 2004 were \$1,363,357.00 and \$1,236,153.00, respectively. Protestant's Exhibit 1, sub-exhibit 4.
5. At all times relevant, Protestant's purchases of inventory and sales to its customers were recorded on its computer system. Tr. 4-5. According to MANAGER, the computer system is preprogrammed to suggest what Protestant might sell and what they need to order, it automatically transmits purchase orders to the wholesalers who in turn transmit an "out-sheet" of unavailable product, and it automatically charges sales tax on the total purchase. Tr. 4-5 and 13.

⁶ OAC, 710:1-5-28(b).

⁷ OAC, 710:1-5-29.

⁸ Protestant invoked his right to a confidential hearing pursuant to 68 O.S. 2001, § 205. See, OAC, 710:1-5-27(d).

⁹ OAC, 710:1-5-32(3).

¹⁰ OAC, 710:1-5-39(a).

6. Protestant's computer system automatically applies a ten percent (10%) discount to case sales. Tr. 6. According to MANAGER, "a lot of wine" and a majority of beer sales are sold by the case. Tr. 6.

7. According to MANAGER, Protestant's mark-up or profit margin for any category of inventory is a "desired mark-up" since they put items on sale and run a lot of sales. Tr. 6-8. Protestant reported on the Inventory Agreement an overall mark-up percentage of plus or minus twenty percent (20%). Protestant's Exhibit 1, sub-exhibit 1.

8. Protestant admits that the inventory reflected by the computer system must be reconciled with a physical inventory which is counted twice a year due to "theft, and a small amount of breakage", which the computer can not tally because this product is not entered into the system. Tr. 11-12.

9. According to AUDIT SUPERVISOR, if an inventory item is not run through Protestant's computer system, the item will not show up in Protestant's total sales to be taxed and it will not be reflected in their gross mark-up calculations because the computer will only show the items that are entered into it. Tr. 32.

10. Protestant also admits that they do not have any documentation as to any theft, breakage or markdowns of inventory. Tr. 13.

11. During 2003 and 2004, Protestant filed its sales tax reports and remitted the reported taxes timely. Tr. 19.

12. On June 13, 2005, the Division initiated a sales tax audit of Protestant for the audit period of January, 2003 through December, 2004, by mailing to Protestant a Records Request for certain documents and a listing of their mark-up percentages for spirits, wine and strong beer by size of the container. Protestant's Exhibit 1, sub-exhibit 1 and Division's Exhibit A.

13. The documents provided to the auditor pursuant to the records request are contained in Protestant's Exhibit 1, which contains all of the requested records. Tr. 5, 19 and 36. See, Protestant's Exhibit 1, sub-exhibit 1 and Division's Exhibit A. Protestant has never been notified that they must keep records to substantiate what they sold by their purchases, nor records of their mark-up percentages, mark-downs or discounts. Tr. 8 and 14.

14. Although requested subsequent to the audit, Protestant has not provided its Z-tapes to the Division. Tr. 31,

15. A projection audit utilizing a "cost mark-up" (depletion) method was performed by the Division on Protestant's sales records and the sales records of Protestant's liquor, wine and beer wholesalers for the months of April and October, 2004, which was extrapolated to the 24 month audit period. Tr. 17, 22-23. Division's Exhibit C. A Division auditor who was assigned the project concerning retail liquor stores and unreported cash sales developed the methodology employed to audit retail liquor stores which is based on purchases. Tr. 16. The methodology was discussed with upper management of the Division. Tr. 17.

16. Protestant was not afforded the opportunity to agree to the sample months chosen by the auditor for purposes of the audit, nor the method chosen for the sample. Tr. 23. See, OAC, 710:65-5-2.

17. In performing the audit, the auditor added Protestant's reported beginning inventory to its purchases from the wholesalers and subtracted out the ending inventory to arrive at a total dollar amount of the spirits, wine and strong beer Protestant had available for sale during 2003 and 2004. The total inventory available for sale was multiplied by a total weighted average mark-up of 20.52% which was determined by taking Protestant's purchases (cost) for each container size of spirits, wine and beer as reflected by the wholesalers' invoices for the months of April and October, 2004, arriving at a percentage of sales for each container size by dividing Protestant's total costs for each container size by Protestant's total purchases for those months and multiplying the mark-up reported by Protestant for each container size by the percentage of sales for each container size. Total additional taxable sales were determined by subtracting Protestant's reported sales from the total inventory available for sale multiplied by the total weighted average mark-up. Tr. 20-21. Division's Exhibit C.

18. Discounts were not allowed in the audit, although Protestant reported on the cost mark-up Records Request case discounts for wine of ten percent (10%) and suitcase and case discounts for strong beer of fifteen percent (15%) and ten percent (10%), respectively. Protestant also reported that they have "close-outs and discounted products every month." Tr. 28 and 38. Protestant's Exhibit 1, sub-exhibit 1.

19. According to AUDIT SUPERVISOR, shrinkage, breakage and discounts were not factored into the weighted average mark-up because no documentation of such was provided by Protestant. Tr. 28 and 37-38.

20. Utilizing the "cost mark-up" (depletion) method, the audit determined that Protestant had overstated its total sales for 2003 in the amount of \$4,553.08 and understated its total sales during 2004 in the amount of \$47,994.46. Division's Exhibit C.

21. As a result of the audit, the Division determined that Protestant had additional taxable sales during the audit period of January 1, 2003 through December 31, 2004 of \$43,441.38, and by letter dated August 22, 2005, proposed the assessment of sales tax, interest and penalty against Protestant in the aggregate amount of \$4,740.24, consisting of tax in the amount of \$3,917.11, interest accrued through October 15, 2005, in the amount of \$431.42 and penalty in the amount of \$391.71. Division's Exhibit C and D. Tr.35.

22. Protestant timely protested the proposed assessment by letter dated August 29, 2005. Division's Exhibit E.

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestant sustained his burden of proving that the proposed sales tax assessment is incorrect in any respect.

Protestant contends that the Division's use of Protestant's purchase records as a basis for a sales tax audit is improper because the Division has failed to show that Protestant's sales records were incomplete or otherwise inadequate. Protestant further contends that the audit method is improper because the Division failed to obtain Protestant's written consent for the sampling method used as required by OAC, 710:65-5-2. Protestant further contends that the Division erred because the audit did not include discounts disclosed to the Division, nor did it take into consideration a margin of error. Protestant further contends that the audit method is improper because they were not on notice, whether by statute, regulation, published policy, or prior communication that they would be required to submit to such audit method, or to keep records to accommodate such audit method.

The Division contends that Protestant failed to sustain their burden of proving the assessment of additional sales tax is incorrect. In support of this contention, the Division argues that because all of Protestant's purchases were made exempt from sales tax as sales for resale, Protestant owes sales tax on those purchases whether the items were sold and not entered into the computer system or were given away. The Division further argues that documentation concerning theft, loss and breakage, along with Z-tapes to substantiate their discounts were requested; however, this information was not provided.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the Commission concludes as a matter of law that:

1. The Tax Commission is vested with jurisdiction over the parties and the subject matter of this action. 68 O.S. Supp. 2002, § 221(D).
2. The collection and remittance of sales tax is governed by the Oklahoma Sales Tax Code ("Code").¹¹ An excise tax is levied upon the gross receipts or gross proceeds¹² of all sales,

¹¹ 68 O.S. 2001, § 1350 et seq.

¹² The terms "gross receipts" or "gross proceeds" are defined to mean "the total amount of consideration for the sale of any tangible personal property or service taxable under the Oklahoma Sales Tax Code, whether the consideration is in money or otherwise. "Gross receipts" or "gross proceeds" shall include, but not be limited to:

- a. cash paid,
- b. any amount for which payment is charged, deferred, or otherwise to be made in the future, regardless of the time or manner of payment,
- c. any amount for which credit or a discount is allowed by the vendor,
- d. any amount of deposit paid for transfer of possession, and
- e. any value of a trade-in or other property accepted by the vendor as consideration, except for used or trade-in parts excluding tires or batteries for a motor vehicle, bus, motorcycle, truck-tractor, trailer, semitrailer or implement of husbandry, as defined in Sections 1-105, 1-125, 1-134, 1-135, 1-162, 1-180 and 1-183 of Title 47 of the Oklahoma Statutes, if the used or trade-in parts are taken in trade as exchange on the sale of new or rebuilt parts.

There shall not be any deduction from the gross receipts or gross proceeds on account of cost of the property sold, labor service performed, interest paid, or losses, or of any expenses whatsoever, whether or not the tangible personal property sold was produced, constructed, fabricated, processed, or otherwise assembled for or at the request of the consumer as part of the sale.

Amended and renumbered by Laws 2003, c. 413, § 1, eff. Nov. 1, 2003. *See*, 68 O.S. Supp. 2004, § 1352(11) which

not otherwise exempted by the Code. 68 O.S. 2001, § 1354(A). Incorporated cities, towns, and counties are authorized to levy taxes as the Legislature may levy for purposes of state government, including a consumer sales tax. 68 O.S. 2001, §§ 2701 et seq. and 1370 et seq., as amended.

3. The sale of “tangible personal property”¹³ is expressly made subject to sales tax. 68 O.S. 2001, § 1354(A)(1). “Sale” is defined in the Code to mean “the transfer of either title or possession of tangible personal property for a valuable consideration regardless of the manner, method, instrumentality, or device by which the transfer is accomplished in this state * * *”. 68 O.S. 2001, § 1352(15).¹⁴ See, OAC, 710:65-1-2. “The taxable event is the sale itself * * *.” *Pioneer Telephone Cooperative, Inc. v. Oklahoma Tax Commission*, 1992 OK 77, 832 P.2d 848; citing with approval, *Phillips v. Oklahoma Tax Commission*, 1978 OK 34, 577 P.2d 1278, 1282, (“In discussing sales tax, it must be emphasized that sales tax is imposed upon the sale itself * * *”); and *Liberty Steel Co. v. Oklahoma Tax Commission*, 1976 OK 83, 554 P.2d 8, 10,

provides:

a. “Gross receipts”, “gross proceeds” or “sales price” means the total amount of consideration, including cash, credit, property and services, for which personal property or services are sold, leased or rented, valued in money, whether received in money or otherwise, without any deduction for the following:

- (1) the seller’s cost of the property sold,
- (2) the cost of materials used, labor or service cost,
- (3) interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller,
- (4) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges,
- (5) delivery charges and installation charges, unless separately stated on the invoice, billing or similar document given to the purchaser, and
- (6) the value of exempt personal property given to the purchaser where taxable and exempt personal property have been bundled together and sold by the seller as a single product or piece of merchandise.

b. Such term shall not include:

- (1) discounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale,
- (2) interest, financing, and carrying charges from credit extended on the sale of personal property or services, if the amount is separately stated on the invoice, bill of sale or similar document given to the purchaser, and
- (3) any taxes legally imposed directly on the consumer that are separately stated on the invoice, bill of sale or similar document given to the purchaser.

See, OAC, 710:65-1-2. Amended at 21 Ok Reg 2581, eff 6-25-04. See also, OAC, 710:65-1-9. Amended at 21 Ok Reg 2581, eff 6-25-04.

¹³ Defined for purposes of the Code to mean “personal property which may be seen, weighed, measured, felt, or touched or which is in any other manner perceptible to the senses”. 68 O.S. 2001, § 1352(17). Amended and renumbered by Laws 2003, c. 413, § 1, eff. Nov. 1, 2003, to include within the meaning “electricity, water, gas, steam and prewritten computer software” and to provided that “[t]his definition shall be applicable only for purposes of the Oklahoma Sales Tax Code”. See, 68 O.S. Supp. 2004, § 1352(23). See also, OAC, 710:65-1-2. Amended at 21 Ok Reg 2581, eff 6-25-04.

¹⁴ Renumbered as § 1352(21) by Laws 2003, c. 413, § 1, eff. Nov. 1, 2003.

“A sales tax, as opposed to a use tax, is imposed on the sale itself and is collectable from the seller”). “For the purpose of proper administration of the provisions of the sales and use tax laws, it is presumed that all gross receipts are subject to tax until they are shown to be tax exempt.” OAC, 710:65-1-4(a).

4. The excise tax levied by the Code is required to be paid by the consumer or user to the vendor, who is required to collect from the consumer or user the full amount of the tax levied or an amount equal as nearly as possible or practicable to the average equivalent thereof, 68 O.S. 2001, § 1361(A); and remit the same to the Tax Commission, 68 O.S. 2001, § 1362(A). The amount to be collected by the vendor on each sale is the applicable percentage of the gross receipts or gross proceeds thereof as provided by § 1354 of the Code which applicable percentage shall equal the combination of the state and any applicable municipal and county sales tax rates rounded to a whole cent. 68 O.S. 2001, § 1362(B). A vendor may elect to compute the tax due on transactions on an item or invoice basis. *Id.* The tax levied by the Code shall be added to the gross receipts not included in the gross receipts. ***Duncan Medical Services v. Oklahoma Tax Commission***, 1994 OK 91, 911 P.2d 247, at 253.

5. In ***Pioneer Telephone***, *supra.*, Pioneer sought a refund of sales taxes on the receipts from its telephone services which it determined were in excess of that necessary to provide the services and which were credited on a pro-rata basis to its customers’ capital accounts in accordance with its end-of-year accounting. In denying the refund, the Supreme Court of Oklahoma held:

The taxable event is the sale itself, and not the cost of operations determined by an accounting method at a future date. The taxable event, the sale of the service, occurs when the cooperative member receives the service and incurs the obligation to pay consideration, the monthly charge, for telephone service.

Id., at 851. In so holding, the Court construed the meaning of “gross receipts” as defined by the Code and according to its plain meaning, and found that “gross receipts includes the consideration for the sale of the service” which includes the cost of the service and any amount allowed as a credit by the seller¹⁵ and that “[t]hus gross receipts refers to the total amount of money or the value of other considerations received from selling property or performing services”, citing *County of Sacramento v. Pacific Gas and Electric Co.*, 193 Cal.App.3d 300, 238 Cal.Rptr. 305, 311 (3 Dist.1987). See, ***Duncan Medical***, *supra.* at 251, wherein the Supreme Court of Oklahoma concluded that “[t]he plain meaning of gross receipts or gross proceeds upon which the sales tax shall be calculated is the total consideration received by the seller or the total obligation incurred by the purchaser at the time of the transaction, if greater than the monetary consideration received by the seller”, citing ***Pioneer Telephone***, *supra.* *Id.*

6. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. OAC, 710:1-5-47. See, ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768

¹⁵ It should be noted that as of November 1, 2003, discounts are excluded from “gross receipts” or “gross proceeds” if they are not reimbursed by a third party. See, Note 12.

P.2d 359. In sales tax matters, “[t]he burden of proving that a sale was not a taxable sale shall be upon the person who made the sale.” 68 O.S. 2001, § 1365(E). See, *Dunn v. State ex rel. Oklahoma Tax Commission*, 1993 OK CIV APP 105, 862 P.2d 1285. Section 1365(E) further provides in pertinent part:

It shall be the duty of every tax remitter required to make a sales tax report and pay any tax under [the Code] to keep and preserve suitable records of the gross daily sales together with invoices of purchases and sales, bills of lading, bills of sale and other pertinent records and documents which may be necessary to determine the amount of tax due hereunder and such other records of goods, wares and merchandise, and other subjects of taxation under [the Code] as will substantiate and prove the accuracy of such returns. * * * All such records shall remain in Oklahoma and be preserved for a period of three (3) years, unless the Tax Commission, in writing, has authorized their destruction or disposal at an earlier date, and shall be open to examination at any time by the Tax Commission or by any of its duly authorized agents.

See, *Kifer v. Oklahoma Tax Commission*, 1998 OK CIV APP 34, 956 P.2d 162.

7. In administrative proceedings, the burden of proof standard is “preponderance of evidence.” 2 Am.Jur.2d *Administrative Law* § 357. See, Oklahoma Tax Commission Order No. 91-10-17-061. “Preponderance of evidence” means “[e]vidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the fact sought to be proved is more probable than not.” Black’s Law Dictionary 1064 (5th ed. 1979). It is also defined to mean “evidence which is more credible and convincing to the mind * * * [T]hat which best accords with reason and probability.” *Id.*

8. Notwithstanding the Division’s contention that the audit performed on Protestant’s business is different than a projection audit (Tr. 23), the fact is the auditor both as to substance and in form employed a projection method without Protestant’s written authorization with respect to the sample periods and the sampling method. Such action is in violation of OAC, 710:65-5-2¹⁶ and prevents the audit herein from providing the substantial evidence necessary for an assessment of additional sales tax in this matter.

9. Protestant’s protest to the proposed sales tax assessment should be sustained.

¹⁶ This rule provides:

An auditor for the Commission may suggest a sample sales/use tax audit rather than a detailed audit. The auditor shall select the periods to sample and apply the results to all the periods of the audit. The auditor shall prepare forms to be signed by the taxpayer stating they agree with the periods and method chosen for the sample.

DISPOSITION

Based on the above and foregoing Findings of Fact and Conclusions of Law the Oklahoma Tax Commission hereby orders the Sales Tax Protest of Protestant, PROTESTANT, be sustained. SO ORDERED.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.