JURISDICTION:	OKLAHOMA TAX COMMISSION
CITE:	2007-06-05-04 (NON-PRECEDENTIAL)
ID:	P-06-098-K
DATE:	JUNE 5, 2007
DISPOSITION:	SUSTAINED IN PART/DENIED IN PART
TAX TYPE:	SALES
APPEAL:	NONE

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above matter comes on for entry of a final order of disposition by the Oklahoma Tax Commission. 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 16th day of February, 2007, as modified on April 3, 2007, the Commission makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

A cost mark-up depletion audit of the stock Protestant had available for sale during the period of January 1, 2003 through December 31, 2004 was performed by the Audit Division of the Oklahoma Tax Commission. As a result of the audit, the Division determined Protestant had unreported sales during the audit period, and by letter dated November 23, 2005, proposed the assessment of sales tax, interest and penalty against Protestant. Protestant timely protested the assessment by letter dated January 20, 2006 [sic].

FINDINGS OF FACT

Upon review of the file and records, including the exhibits received into evidence, the Commission finds:

1. Protestant is the owner of and does business as LIQUOR STORE, a retail liquor store located in BIG CITY, Oklahoma. Exhibit A.[1]

2. Protestant operates his business under sales tax permit number XXX. Exhibit A.

3. A cost mark-up depletion audit of the stock Protestant had available for sale during the period of January 1, 2003 through December 31, 2004 was conducted by the Division utilizing the sales records of Protestant's wholesalers and Protestant's mark-up percentages for spirits, wine and strong beer. Exhibits B[2] and D[3]. Neither a beginning nor ending inventory was used in performing the audit. Exhibit C.[4]

[1] Consists of Oklahoma Tax Commission/Audit Division – Taxpayer's List of Principal Officers, Partners or Members(LLC) executed by Protestant on May 17, 2005 and a Business Registration filed by Protestant with the Tax Commission on November 8, 2001.

[2] Sales tax audit work papers.

4. Protestant's purchases (cost of goods) during the audit period totaled $716,730.94, as reflected by the sales records of Protestant's wholesalers, inclusive of credits for returns. Exhibits B and H[5].

5. Protestant's audited gross receipts for the audit period were $895,913.68, which was calculated by applying an averaged mark-up of twenty-five percent (25%) to Protestant's purchases. Exhibit B. The averaged mark-up was determined from the mark-up percentages supplied by Protestant. Exhibit D.

6. Protestant's audited unreported sales for the audit period were $316,813.68, which was calculated by subtracting Protestant's reported sales for the audit period of $579,100.00 from the audited gross receipts. Exhibit B.

7. As a result of the depletion audit, the Division by letter dated November 23, 2005 proposed the assessment of state, city and county sales taxes in the aggregate amount of $26,983.03 on the audited unreported sales, interest at fifteen percent (15%) through January 31, 2006 of $4,169.43, for a total of tax and interest due within thirty (30) days of $31,152.46, and a thirty (30) day delinquent penalty at ten percent (10%) of $2,698.30, for a total of tax, interest and penalty due after thirty (30) days of $33,850.76.[6] Exhibit F[7]. *See*, 68 O.S. Supp. 2004, § 217(C).

8. Protestant timely protested the assessment by letter dated January 20, 2006 [sic]. Exhibit G.

ISSUE AND CONTENTIONS

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

Protestant disputes several aspects of the audit. First, Protestant requests that the beginning and ending inventories for 2003, which were submitted to the auditor subsequent to the audit, be considered in determining his sales during 2003. The Division objects to the use of the beginning and ending inventories because Protestant failed to provide supportive documentation of the inventories, such as Schedule C of his 2003 federal tax return. Second, Protestant contends that the 2003 sales records of two (2) of his wholesale suppliers are incorrect

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[3] Oklahoma Tax Commission Audit Division Records Request and work paper.

[4] Business Tax Mixed Beverage Audit Form

[5] Letter dated October 13, 2006, from the representative of the Division to Protestant, which explained the reasons for denying any adjustments to the proposed assessment and proposed a settlement.

[6] Protestant is also delinquent in the remittance of reported sales taxes for certain tax periods covering September, 2000 through November, 2005, as represented by tax warrant number STS-xxx-00. Exhibit I.

[7] Proposed sales tax assessment letter.

in that the records did not give him credit for $4,100.00 in returned items.[8] The Division states that the auditor subsequently spoke with representatives of the two (2) wholesale suppliers, that the suppliers confirmed their sales records, and therefore no further credit allowances should be granted. Third, Protestant requests some relief for spoilage, breakage and theft. The Division objects, arguing that there is no statutory relief for breakage or spoilage with regard to liquor store sales. Fourth, Protestant requests some relief for items he donated or gave away as gifts. The Division argues that whether Protestant gave away the items or consumed them himself, the items are subject to sales tax as items withdrawn from his resale inventory. Finally, Protestant requests that the averaged mark-up percentage be changed from 25% to 20.27%. The Division objects to any unsubstantiated changes to the audit, citing the audit form signed by Protestant. Exhibit H.

In its brief, the Division offers two (2) propositions in support of its request for a recommendation denying Protestant's protest. The first proposition is "[t]he law requires persons selling alcoholic beverages to remit sales tax to the Commission upon the total retail value from such sales." In support of this proposition, the Division cites 68 O.S. 2001, § 1354(A)(9) and *OAC*, 710:65-19-5. The second proposition is "[t]he protestant bears the burden of proof in a tax case set before the administrative law judge." In support of this proposition the Division cites 68 O.S. 2001, § 1365(E) and *OAC*, 710:1-5-47.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned 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").[9] An excise tax is levied upon the gross receipts or gross proceeds[10] of all sales,

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[8] The ALJ's notes during the Pre-hearing Conference held on August 22, 2006.

[9] 68 O.S. 2001, § 1350 et seq.

[10] 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

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"[11] is expressly made subject to sales tax. 68 O.S. 2001, § 1354(A)(1). "Sale" is defined 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).[12] *See, OAC*, 710:65-1-2. "The taxable event is the sale itself * * *." ***Pioneer***

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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 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:
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> (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.
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> b. Such term shall not include:
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> (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.

[11] Defined by 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.

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

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, ("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 seller 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 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. The Tax Commission has adopted the depletion method for auditing the total gross receipts of "every mixed beverage tax permit holder or other person transacting business subject to the gross receipts tax" levied by § 576 of the Oklahoma Alcoholic Beverage Control Act ("Act")[13] which method accounts for "the number of drinks available for sale, preparation, or service from the total alcoholic beverages received."[14] The depletion method has been determined to be a reasonable and valid method for determining the total gross receipts subject to tax under § 576. ***Kifer,*** *supra* at ¶ 11. Head-note 6 to the ***Kifer*** opinion states:

> Substantial evidence supported Tax Commission's use of taxpayer's drinks available for sale, rather than taxpayer's actual cash register receipts, in calculating the mixed beverage gross receipts tax; taxpayer did not keep records of its beginning and ending inventories or pour sizes and could not verify that all sales receipts were deposited into the cash

[13] 37 O.S. 2001, § 502 et seq.

[14] Oklahoma Tax Commission Order No. 85-05-16-02. Currently codified at *OAC*, 710:20-5-8. Last amended at 19 Ok Reg 1507, eff 5-25-02.

> register, and thus, Commission had no option other than using a depletion analysis that was based on purchases from wholesaler and inventory on hand at end of audit period.

In response to the ***Kifer*** opinion, the Legislature amended § 579 by adding subsection G.[15] Section 579(G) provides:

> In addition to any other authority granted by law, the Tax Commission is hereby authorized to audit any mixed beverage, beer and wine, caterer or special event licensee to determine if the correct amount of tax payable under Section 576 of this title has been collected; provided, if such an audit reveals that the amount collected is within the following percentages of the amount of tax payable, the taxpayer shall be deemed to be in compliance:
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> 1. For spirits, eighty-four percent (84%) to one hundred sixteen percent (116%);
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> 2. For wine, ninety percent (90%) to one hundred ten percent (110%);
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> 3. For beer sold at draft and not in original packages, eighty-six percent (86%) to one hundred fourteen percent (114%); and
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> 4. For beer sold in original packages, ninety-five percent (95%) to one hundred five percent (105%).

See, OAC, 710:20-5-8(b).

10. Although the Oklahoma statutes require margin of error percentages to be factored in when the Division performs a depletion audit on the holder of a mixed beverage tax permit, no statute establishes an appropriate margin of error percentage for depletion audits on retail liquor stores. A retail liquor store like any other retailer of consumer goods and merchandise has shrinkage of inventory whether the same is cause by spoilage, breakage or theft. *See,* ***Finaserve, Inc. v. Oklahoma Tax Commission***, 1991 OK CIV APP 97, 828 P.2d 440, (wherein the Court held that "[a] fact finder may not properly ignore the facts of a rising or falling market, or of obsolescence of the equipment"). Because the Commission recognizes the reality of theft and breakage which sometimes occur in a retail environment and also recognizes the different environments which exist between establishments which sell alcoholic beverages for consumption on the premises and alcoholic beverages which are sold for consumption elsewhere, the Commission finds that a two percent (2%) margin of error should be factored into the depletion audit of retail liquor stores.

11. With respect to Protestant's use or consumption of its inventory, if any; personally or by way of gifts of the same, sales tax would be due on the "sales value" of the inventory.

[15] Laws 2001, c. 78, § 9, eff. Nov. 1, 2001.

68 O.S. 2001, § 1362(D).[16] However, Protestant has not come forward with any evidence to show what inventory was donated or given away as gifts. Further, Protestant has failed to produce any evidence to substantiate the remaining factual aspects of the protest.

ORDER

Protestant's protest should be and the same is hereby sustained in part and denied in part. The sales tax assessment is adjusted by a factor of two percent (2%) of the amount of tax due, resulting in a reduction in the amount of tax due from $26,983.03 to $26,443.37. Interest on this amount at 15% per annum from November 23, 2005, until paid and penalty of $2,644.34 is also assessed. Protestant's protest to the sales tax assessment is otherwise denied.

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.

[16] This provision provides in pertinent part:

> [E]ach person required pursuant to the provisions of the Oklahoma Sales Tax Code to make a sales tax report shall include in the gross proceeds derived from sales to consumers or users, the sales value of all tangible personal property which has been purchased for resale, manufacturing, or further processing, and withdrawn from stock in trade for use or consumption during the taxable period covered by such report, and shall pay the tax on the sales value of this tangible personal property withdrawn from stock in trade for consumption or use * * *.

See, OAC, 710:65-1-2 which provides in respect to the facts of this proceeding:

> (E) Otherwise, **"sales value"** means the larger of either the vendor's cost at the time the exempt purchase of goods was made, or the price at which it would be sold to the vendor's best customer in the ordinary course of business.