JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2008-04-10-02 / NON-PRECEDENTIAL**
ID: **P-07-021-K**
DATE: **APRIL 10, 2008**
DISPOSITION: **SUSTAINED IN PART / DENIED IN PART**
TAX TYPE: **SALES**
APPEAL: **NO APPEAL TAKEN**

ORDER

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 14th day of January, 2008, and the application of Protestant for an En Banc Hearing before the Commission, the Commission denies the application for an En Banc Hearing and makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

A projection method depletion audit of the stock Protestant had available for sale during the first quarter of 2004 and the third quarter of 2005 was performed by the Audit Division of the Tax Commission. As a result of the audit, the Division determined Protestant had unreported sales during the audit period of January 1, 2004 through December 31, 2005, and by letter dated August 18, 2006, proposed the assessment of sales tax, interest and penalty against Protestant. Protestant timely protested the assessment by letter dated September 13, 2006.

On February 5, 2007, the protest was referred to the Office of the Administrative Law Judges ("ALJ's Office") for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure before the Oklahoma Tax Commission[2]. The protest was docketed as Case No. P-07-021-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for March 14, 2007, by *Prehearing Conference Notice* issued February 22, 2007.[4] The conference was held as scheduled. Pursuant to the conference, further proceedings were stayed pending a final determination in a similar case pending before the Tax Commission.

A hearing was scheduled for September 19, 2007, by *Notice of Hearing* issued August 22, 2006.[5] A closed hearing[6] was held as scheduled with the parties in attendance. The

[1] 68 O.S. 2001, § 201 et seq.

[2] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code* ("*OAC*").

[3] *OAC*, 710:1-5-22(b).

[4] *OAC*, 710:1-5-28(a).

[5] *OAC*, 710:1-5-29.

Division called two witnesses: AUDITOR, Field Auditor; and SUPERVISOR, Audit Supervisor, who testified regarding the performance of the audit and the records of the Division. Division's Exhibits A through O were identified, offered and admitted into evidence. Protestant made a statement under oath and offered Protestant's Exhibits 1 through 11, which were admitted into evidence. Upon conclusion of the hearing, the record was closed and the protest was submitted for decision.[7]

FINDINGS OF FACT

Upon review of the file and records, including the tape recording of the hearing and the exhibits received into evidence, the undersigned finds:

1. Protestant is the owner of and does business as STORE, a retail package liquor store located in CITY, Oklahoma. Division's Exhibit D and testimony of PROTESTANT.

2. Protestant operates her business under sales tax permit number XXX. Division's Exhibit E.

3. Protestant agreed to the use of an error rate projection method for determining her gross sales during the period of January 1, 2004 through December 31, 2005 ("audit period"). The sample periods selected for the error rate projection were the first quarter of 2004 and the third quarter of 2005. Division's Exhibit B.

4. The auditor testified that he utilized a weighted average mark-up depletion audit of the product Protestant had available for sale during the audit period because he wanted to verify the accuracy of Protestant's reported sales, and because the information supplied by Protestant to verify gross sales did not match up. According to the auditor, Protestant's cash register z-tapes and bank statements for the sample periods did not match up with Protestant's reported gross sales for those periods. PROTESTANT testified that matching bank deposits to sales receipts is inaccurate since the account includes funds she deposited to the account and returned checks – collected and deposited at later dates. Although certain items were removed from Protestant's bank deposits as non-product sales, the Division comparison of the bank deposits and reported gross sales reflects Protestant over-reported her sales for the audit period by an estimated amount of approximately $10,500.00. Division's Exhibit O.

5. Comparing Protestant's cash register z-tapes to reported sales shows gross sales were over-reported by an estimated amount of approximately $2,000.00 for 2004 and under-reported by an estimated amount of approximately $2,300.00 for 2005. Division's Exhibit N. Protestant calculated her unreported sales at $2,264.16 for 2004 and $3,808.48 for 2005, due to the fact that she would make adjustments to her receipts depending on whether the cash registers were short or long on a given night. Protestant's Exhibit 3 and testimony of PROTESTANT.

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[6] 68 O.S. 2001, § 205. *See*, *OAC*, 710:1-5-27(d).

[7] *OAC*, 710:1-5-39(a).

6. The auditor also reviewed Protestant's 2004 and 2005 Federal income tax returns, noted the gross sales and cost of goods sold as reported thereon and determined that the reported gross sales on the income tax returns did not match up with the reported gross sales on Protestant's sales tax reports. Upon comparison of the figures, the auditor testified that gross sales for 2004 were off by $1.00, and gross sales for 2005 were off by approximately $7,000.00. Division's Exhibits D and G.

7. The auditor used the purchases as reported on Protestant's Federal income tax returns as opposed to the purchases reported by the wholesalers to take into account other purchases of product. Protestant admits she purchased wine from Oklahoma wineries during the audit period. The income tax returns report additional purchases of $23,028.93 for the audit period. Division's Exhibit C2 and testimony of PROTESTANT.

8. In performing the audit, the auditor did not use the 24.18% mark-up reported by Protestant, but rather used a weighted average mark-up of 34.18% which was determined from the prices of sales samples for each brand taken during an in-store inspection and the costs of those sales samples, as reflected on current invoices. The sales samples were then categorized by product type and size of container to determine the weighted average mark-up. Further, Protestant's inventory available for sale and the weighted average mark-up were adjusted for discounts and specials. Division's Exhibits G, I and J, and testimony of AUDITOR. PROTESTANT identified Protestant's Exhibit 5, which purportedly shows the corrections to several errors regarding the prices and costs of the product samples used to determine the weighted average mark-up percentage.

9. Protestant's audited unreported sales for the audit period were $116,356.27, which was calculated by subtracting Protestant's reported sales of $1,073,818.00 from the audited expected sales of $1,190,174.27. Protestant's cost of goods sold during the audit period was $901,960.00. Division's Exhibits E and G.

10. As a result of the depletion audit, the Division by letter dated August 18, 2006, proposed the assessment of state, city and county sales taxes in the aggregate amount of $8,726.72 on the audited unreported sales, interest at fifteen percent (15%) through October 31, 2006 of $2,739.45, for a total of tax and interest due within thirty (30) days of $11,466.17, and a thirty (30) day delinquent penalty at ten percent (10%) of $872.67, for a total of tax, interest and penalty due after thirty (30) days of $12,338.84. Division's Exhibits E and F. *See*, 68 O.S. Supp. 2004, § 217(C).

11. Protestant timely protested the proposed assessment by letter dated September 13, 2006. Division's Exhibit H.

12. To account for Protestant's specials and discounted products, the Division proposed several different methods to determine an appropriate mark-down percentage. Protestant's Exhibits 9, 10 and 11. Utilizing the mark-down percentage most favorable to Protestant, the Division arrived at audited unreported sales for the audit period of $98,672.13, and by letter dated February 23, 2007, issued a revised proposed assessment of state, city and county sales taxes in the aggregate amount of $7,400.41, interest at fifteen percent (15%) through March 31,

2007 of $1,750.55, for a total of tax and interest due within thirty (30) days of $9,150.96, and a thirty (30) day delinquent penalty at ten percent (10%) of $740.05, for a total of tax, interest and penalty due after thirty (30) days of $9,891.01. Division's Exhibits K and L.

13. The revised proposed assessment was revised on June 15, 2007, by reducing the unreported sales by 2% to account for the two percent (2%) shrinkage allowance adopted by the Commission. The amount in controversy, inclusive of interest accrued through July 31, 2007, is $11,053.40, consisting of tax in the amount of $7,252.40, interest in the amount of $3,075.76 and penalty in the amount of $725.24. Division's Exhibit M.

14. At the hearing, PROTESTANT submitted Protestant's Exhibit 1, which was identified as a list of employee purchases of product at cost and Protestant's Exhibits 6 and 7, which were identified as an incident of employee theft that resulted in the termination of the employee and the denial of unemployment benefits do to the allegations of theft. PROTESTANT testified that the list of employee purchases was compiled from the time sheets kept at the business. According to the auditor, he never reviewed any records to support the employee purchases. PROTESTANT also testified that the employee who was terminated because of theft was a long-term full time employee that worked six (6) days per week. She estimated that $50.00 to $60.00 worth of product was allowed to be pilfered by the employee each day, amounting to $32,760.00 over the audit period. On cross-examination, PROTESTANT testified that her estimate is based on a review of a security camera tape recording over a one (1) week period.

15. PROTESTANT calculates her unreported sales for the audit period to be $5,817.92 and a tax due of $436.34, based on a mark-up of 32.99% less weekly mark-downs, 2% inventory shrinkage, 2% close out items, purchases at cost and employee theft. Protestant's Exhibit 8.

16. Protestant also submitted statistical data showing a range of shrinkage of 1.63% to 2.10%. Protestant's Exhibit 4. Protestant admits that the data was not formulated for package liquor stores.

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestant sustained her burden of proving that the proposed assessment is incorrect.

Protestant raises three issues with respect to the audit and assessment. First, Protestant objects to the method used to calculate her gross sales. In support of this objection, Protestant argues that her records show her reported sales are accurate based on her sales receipts. The Division contends that the method used to determine Protestant's gross sales is the best method to determine Protestant's true sales for the audit period. In support of this contention, the Division argues that none of Protestant's financial information matched her reported gross sales and that Protestant admits to altering her sales depending on whether her cash registers were short or long.

Protestant further objects to the disallowance of any inventory shrinkage in computing her gross sales for the audit period. In support of this objection, Protestant submits statistical data showing a range of inventory shrinkage of 1.63% to 2.10%. The Division would show that the last revision took into account a 2% allowance for shrinkage due to theft, breakage and spoilage. The Division argues that any additional allowances for theft, spoilage and breakage must be proven by police reports or insurance claims which document the exact amount of loss.

Protestant finally takes exception with the mark-up percentage used by the Division. In support of this exception, Protestant cites the pricing and cost errors for the sample products used in calculating the mark-up percentage. Protestant further argues her mark-up percentage is approximately 25%, as reflected on the form she submitted to the Division. The Division contends that the mark-up percentage was calculated using prices for product as reflect on the store shelves during the in-store inspection and costs from Protestant's current invoices. The Division further contends that specials and discounts have been factored into the mark-up percentage by the mark-down percentage allowed by the Division.

CONCLUSIONS OF LAW

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

1. The Tax Commission is vested with jurisdiction of 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").[8] An excise tax is levied upon the gross receipts or gross proceeds[9] of all sales,

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[8] 68 O.S. 2001, § 1350 et seq.

[9] 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, semi trailer 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 provides:

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"[10] 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).[11] *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, ("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).

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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.

[10] 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.

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

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[12] 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:

[12] 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.

> 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. In response to Protestant's objections, the Commission has approved the use of the depletion method in auditing retail package liquor stores. Oklahoma Tax Commission Order No. 2007-06-05-04. See ***Kifer***, *supra*.[13] The Division's mark-up percentage is based on a visual inspection of the sample products and the current invoices. Protestant has not presented sufficient evidence to overcome the Division's mark-up percentage nor to support a mark-up percentage different than that employed by the Division. With respect to Protestant's allegations of purchases at cost, she did not present any back-up documentation such as sales invoices, nor corroborating testimony. Protestant's evidence of stolen merchandise is also insufficient since the same is not documented by types of product stolen – brands and bottle sizes. OAC, 710:20-5-8(b)(4)(c).

9. Protestant's protest to the methodology used by the Division in applying the 2% loss allowance has merit. The Commission has determined that the language used in Commission Order No. 2007-06-05-04 which set out the Commission policy of utilizing a 2% loss allowance in audits of retail liquor package stores was ambiguous, resulting in the methodology used in the

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[13] 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 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.

present assessment. The Commission now clarifies that in audits of retail liquor package stores a 2% loss allowance is to be applied in the same manner as the allowances provided to mixed beverage, beer and wine, caterer and special events licensees by subsection G of Section 579 of Title 37 of the Oklahoma Statutes. If the audit reveals the amount collected and remitted is within the range of 98% to 102% of the amount of tax payable, the taxpayer shall be deemed to be in compliance.

10. Protestant's protest to the methodology used in applying the 2% loss allowance is sustained and the protest is denied as to all other issues.

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.