JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2010-06-08-03 / NON-PRECEDENTIAL**
ID: **P-09-141-K**
DATE: **JUNE 8, 2010**
DISPOSITION: **DENIED**
TAX TYPE: **SALES**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestant, COMPANY is represented by CPA, Certified Public Accountant, FIRM. The Compliance Division of the Oklahoma Tax Commission (hereinafter "Division") is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

A field audit of Protestant's available records for the audit period inclusive of February, 2006 through January, 2009 was performed by the Division. As a result of the audit, the Division by letter dated July 2, 2009, proposed the assessment of additional sales tax, interest and penalty against Protestant. The assessment was timely protested. A hearing was not requested in the letter of protest.

On September 1, 2009, the protest was referred to the Office of the Administrative Law Judges for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure before the Office of the Administrative Law Judges[2]. The protest was docketed as Case No. P-09-141-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for November 2, 2009, by *Prehearing Conference Notice* issued September 15, 2009.[4] Protestant's letter requesting a thirty (30) day continuance of the conference was accepted as a report in lieu and the parties were instructed to file a status report on or before December 2, 2009. Pursuant to the *Status Report* filed by the Division, the case was scheduled for a status conference by *Notice of Status Conference* issued December 9, 2009. Protestant failed to respond to the notice, and by letter dated January 6, 2010, the parties were notified that the protest would be submitted for decision upon the filing of a verified response to protest by the Division and a reply to said response by Protestant.[5]

The *Division's Verified Response to Protest* and Exhibits A through H were filed February 5, 2010. By letter filed February 22, 2010, Protestant requested additional time to file a

[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*, 710:1-5-28(c).

reply to the Division's verified response, which was granted by *Order Granting Request for Extension of Time* issued February 25, 2010. Protestant was granted to March 22, 2010 to file the reply. Protestant failed to file the reply. In accordance with the Court's directive of January 6, 2010, as modified by the *Order* issued February 25, 2010, the record was closed and the protest was submitted for decision on March 26, 2010.[6]

FINDINGS OF FACT

Upon review of the file and records, including the *Division's Verified Response to Protest* and exhibits, and Protestant's pleadings, the undersigned finds:

1. Protestant owns and has operated since May 1, 1992, a Mexican restaurant in ANYTOWN, Oklahoma under sales tax permit number ###. The restaurant serves Mexican and American food; and margaritas, strong beer and low-point beer. Exhibit A[7] and *Field Audit Write-up* prepared by AUDITOR, Auditor on June 5, 2009[8].

2. A comparison of sales tax collected to sales tax remitted could not be made because Protestant was unable to provide cash register tapes or any worksheets detailing how it determined its reported sales or the sales tax collected during the periods inclusive of February, 2006 through January, 2009 ("audit period"). In addition, the sales reported on the sales tax reports did not reconcile with either the sales reported on Protestant's income tax returns or the bank deposits. Exhibit G[9], Schedules 402.01[10], 402.09[11] and 402.10[12]; *Field Audit Write-up*.

3. An error rate projection sales tax audit of Protestant's sales of mixed beverages, low-point beer and food for the audit period was conducted by a Division auditor utilizing the sample months of February, 2007; April, 2008; and December, 2008 as selected by the Rat-Stats Random Number Selection Program ("Rat-Stats Program").[13] The primary information utilized

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

[7] Business Registration.

[8] Submitted as part of the protest file referred to this office on September 1, 2009, and accepted as part of the record in this cause by official notice. *OAC*, 710:1-5-36.

[9] Audit documents and taxpayer records.

[10] Audit schedules.

[11] Bank statements for sample periods.

[12] 2006, 2007 and 2008 income tax returns.

[13] Audit Methodology Agreements executed by a representative of Protestant and the Division auditor were included as part of the *Field Audit Write-up*. The Agreements reflect consent to the use of the "Rat-Stats Program" for selecting the sample periods to be used in the sampling and error rate projection audit, the use of a "sampling and error rate projection methodology" for determining the "sales and tourism" taxes due for the audit period, the use of "a percentage of sales methodology" for determining the "average glass size for margaritas", "a percentage of sales methodology" for determining the amount of "3.2 beer and mixed beverage sales to total sales", and a "sampling methodology" for determining the "sales percentage for margarita sizes". The Rat-Stats Program also selected the month of October, 2006 as a sample period; however, by agreement this period was dropped and not replaced upon

to perform the audit was Protestant's order tickets written by wait staff and given to the customer at the end of a meal to take to the cash register to pay out. The sales tax collected from the customer was not separately listed on the tickets. The order tickets were bundled in daily stacks and were totaled at the end of the month for use in the preparation of Protestant's sales tax reports.[14] The auditor noted that "the sequential order of the tickets were intermittent, ranging from one or two tickets numbers missing to large blocks [sic] numbers missing." Exhibit G, Schedule 402.06[15]; *Field Audit Write-up*.

4. The only products sold by Protestant that were subject to the mixed beverage gross receipt tax were strong beer, and frozen and "rocks" margaritas. Exhibit G, Schedule 402.07[16]; *Field Audit Write-up*.

5. As part of the mixed beverage audit, the number of drinks and strong beers sold as shown on Protestant's order tickets, multiplied by the prices provided by Protestant, less the mixed beverage tax, were compared to the amount of gross sales reported on the filed mixed beverage tax reports. This comparison revealed underreported mixed beverage sales for each sample period. Exhibit G, Schedules 402.01 and 402.06; *Field Audit Write-up*.

6. The audited mixed beverage and strong beer sales were computed by applying a weighted average pour size and weighted average drink price to the purchases of liquor and strong beer[17] provided by the suppliers. The weighted average pour size and drink price were determined from the order tickets[18] and the pricing provided by Protestant. Spillage allowances of five percent (5%) for bottled beer and sixteen percent (16%) for liquor were factored into the purchased inventory[19]. *OAC*, 710:20-5-8(b)(3)(A) and (D). Exhibit G, Schedule 402.06; *Field Audit Write-up*.

7. The mixed beverage depletion audit determined that Protestant had underreported its mixed beverage and strong beer sales during the audit period in the total amount of $56,731.64

Protestant's inability to locate any records for this period and a review of the records of the remaining three (3) sample periods. See, *Field Audit Write-up*.

[14] According to the *Field Audit Write-up*, the monthly gross sales reported by Protestant probably included sales tax. The auditor also noted that Protestant's monthly reported gross sales reconciled with the total sales shown on the order tickets. Exhibit G, Schedule 402.01.

[15] Sampling of sales/order tickets.

[16] Taxpayer notes.

[17] The purchase invoices provided by the suppliers reflected unaccounted for purchases of $788.27 by Protestant during the audit period. According to the *Field Audit Write-up*, these purchases were depleted at cost since they were not sold in the restaurant.

[18] The order tickets reflect the number of beers sold per category, the number of "rocks" verses frozen margaritas sold and the number of margaritas sold per size. *Field Audit Write-up*.

[19] No ending inventory deduction was allowed against the purchased inventory since Protestant did not provide a beginning inventory. *OAC*, 710:20-5-8(b)(5). *Field Audit Write-up*.

which sales were included in the sales tax audit and subjected to sales tax[20]. Exhibit H[21]; *Field Audit Write-up*.

8. The sales tax audit also included a low-point beer depletion audit and a food cost percentage markup audit. As part of the low-point beer depletion audit, the number of beers purchased during the sample periods as reflected by the supplier invoices[22] multiplied by the price provided by Protestant ($2.50) was compared with the number of beers sold as reflected on the order tickets for the sample periods multiplied by the price[23]. This comparison found underreported low-point beer sales for the sample periods. Exhibit G, Schedules 402.01 and 402.02[24]; *Field Audit Write-up*.

9. The audited sales of low-point beer were determined by multiplying the price provided by Protestant to the purchases provided by the suppliers for the audit period.[25] The reported sales of low-point beer for the audit period was obtained by computing a percentage (total sales for the sample months divided by the low-point beer sales as reflected on the order tickets multiplied by the price for the sample months) which was applied to Protestant's total sales for the remaining months of the audit period. Exhibit G, Schedule 402.02; *Field Audit Write-up*.

10. The low-point beer depletion audit determined that Protestant had underreported its sales of low-point beer during the audit period by a total amount of $26,898.58. Exhibit G, Schedule 402.02; *Field Audit Write-up*.

11. The auditor used a thirty-two percent (32%) food cost mark-up to audit Protestant's food sales during the audit period.[26] Exhibit F[27] and D[28]; *Field Audit Write-up*. The audited food costs for the sample periods was determined from Protestant's general ledger cost of goods

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[20] Protestant did not challenge the results of the mixed beverage depletion audit because as stated by Protestant's representative, "taxpayer did not track spillage, spoilage, personal use, and give-aways [sic]". However, Protestant argues that "all the actual sales were reported, and should not affect the sales report." July 28, 2009 Protest letter.

[21] Summary report and supporting schedule.

[22] According to the *Field Audit Write-up*, a comparison of the low-point beer purchase invoices provided by Protestant to the purchase information provided by the suppliers did not reveal any significant differences.

[23] Sales taxes were included in this calculation since Protestant had included sales tax in its reported gross sales. *Field Audit Write-up*.

[24] Assessment worksheets.

[25] The 2006 purchase information provided by the supplier was a yearly total rather than monthly totals, so an average of the 2007 and 2008 monthly purchases was computed and applied to the 2006 yearly total to ascertain the monthly purchases. No ending inventory deduction was allowed against the purchased inventory since Protestant did not provide a beginning inventory. *OAC*, 710:20-5-8(b)(5). A spillage allowance of five percent (5%) was factored into the purchase inventory. *OAC*, 710:20-5-8(b)(3)(5). *Field Audit Write-up*.

[26] A completed "Food Cost Percentages" agreement was not returned to the auditor. The agreement provides that if a completed form is not returned to the auditor, a standard 32% cost percentage for food shall be the default method to establish food cost percentage.

[27] Includes the records requested by the auditor to perform the audit.

[28] Division's citation of authority for use of a 32% cost mark-up.

sold account and calculated by deducting the mixed beverage and low-point beer purchases from the monthly total purchases posted to the account and multiplying that figure by 3.125. The reported food sales were deducted from the audited food sales leaving underreported food sales for the audit period in the amount of $843,432.30. Exhibit G, Schedule 402.08[29] and 402.01; Exhibit H and *Field Audit Write-up*.

12. The sales tax audit also included two (2) purchase invoices showing Protestant purchased a cash register system from a vendor in CITY, Oklahoma without paying sales tax. The purchase price of $6,127.00 was entered as a line 2 withdrawal from inventory and subjected to state and city of CITY sales tax. Exhibit G, Schedule 402.02; Exhibit H and *Field Audit Write-up*.

13. By letter dated July 2, 2009, the Division caused to be issued a proposed assessment of state, city and county sales taxes in the aggregate amount of $87,480.39 on the audited underreported sales and line 2 withdrawal from inventory, interest at fifteen percent (15%) through August 31, 2009 of $22,402.87, and a thirty (30) day delinquency penalty at ten percent (10%) of $8,748.04, for a total of tax, interest and penalty due of $118,631.30. Exhibits B and H.

14. Protestant timely protested the proposed assessment by letter dated July 28, 2009. Exhibit C.

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestant sustained its burden of proving that the sales tax audit and resulting proposed assessment are incorrect.

Protestant contends that the 32% food cost mark-up should not have been applied to its restaurant operations. In support of this contention, Protestant asserts that its order tickets and calculator tapes are sufficient to show its gross sales. Protestant further asserts that its own study of another Mexican restaurant shows a 32% mark-up cannot be applied to every restaurant.

The Division contends that Protestant failed to show the proposed assessment is erroneous. In support of this contention, the Division argues that Protestant has not presented any evidence to prove its allegations.

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 proceeding. 68 O.S. Supp. 2002, § 221(D).

[29] Food sales and general ledgers for sampling periods.

2. The collection and remittance of sales tax is governed by the Oklahoma Sales Tax Code ("Code").[30] An excise tax is levied upon the gross receipts or gross proceeds[31] of all sales, 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. Sales of "[F]oods, confections, and all drinks sold or dispensed by hotels, restaurants, or other dispensers, and sold for immediate consumption upon the premises or delivered or carried away from the premises for consumption elsewhere" are expressly made subject to sales tax. 68 O.S. Supp. 2007, § 1354(A)(10)[32].

4. Every tax remitter[33] required to make a sales tax report and pay any tax under the Code has the duty to keep and preserve for a period of three (3) years 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

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[30] 68 O.S. 2001, § 1350 et seq.

[31] The terms "gross receipts", "gross proceeds" or "sales price" mean 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.

68 O.S. Supp. 2004, 1352(12)(a). 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.

[32] Laws 2007, c. 155, § 5, eff. Nov. 1, 2007.

[33] Defined at 68 O.S. Supp. 2004, § 1352(26) to mean "any person required to collect, report or remit the tax imposed by the [Code]. A tax remitter who fails, for any reason, to collect, report, or remit the tax shall be considered a taxpayer for purposes of assessment, collection, and enforcement of the tax imposed by the [Code]". Renumbered as paragraph 27 by Laws 2007, c. 155, § 4, eff. Nov. 1, 2007.

due 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. 68 O.S. Supp. 2003, § 1365(F). See *OAC*, 710:65-3-31(a)[34].

5. "A taxpayer is responsible for record keeping." ***Kifer v. Oklahoma Tax Commission***, 1998 OK CIV APP 34, ¶ 11, 956 P.2d 162, 165. In ***Kifer***, the Tax Commission due to insufficient recordkeeping by the taxpayer estimated taxpayer's gross receipts based on the number of drinks available for sale utilizing a depletion method of taxpayer's purchases from the wholesaler and inventory on hand. The Court of Civil Appeals held that "[s]ubstantial evidence supports the position of Commission in its method of determining [taxpayer's] taxes", adopting the reasoning of a Texas Court of Appeals in *Big Country Club, Inc. v. Humphreys*[35], wherein the Court found "[w]e think common sense would dictate that if a taxpayer fails to make reports or to keep proper records, some formula must be devised to determine the tax imposed by legislative authority" and "any other rule would make it impossible for the state to collect the taxes owed".

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. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359. The burden of proof and the burden of persuasion on each issue are borne by the taxpayer, the proponent of the issues.

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. Protestant failed to present any evidence to show that the audit and resulting proposed assessment are incorrect. Accordingly, Protestant's protest to the proposed sales tax assessment should be denied.

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[34] This rule provides:

> **Required records**. The following records constitute a minimum requirement for the purposes of the Sales Tax Code for vendors selling tangible personal property:
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> (1) Sales journal or log of daily sales in addition to cash register tapes and other data which will provide a daily record of the gross amount of sales.
> (2) A record of the amount of merchandise purchased. To fulfill this requirement, copies of all vendors' invoices and taxpayers' copies of purchase orders must be retained serially and in sequence as to date.
> (3) A true and complete inventory of the value of stock on hand taken at least once each year.

[35] 511 S.W. 2d 315 (Tex.Civ.App. 1974).

DISPOSITION

THEREFORE, based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of Protestant, COMPANY, be denied. It is further ORDERED that the amount in controversy, inclusive of any additional accrued and accruing interest, be respectively fixed as the deficiency due and owing.

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.

NOTE: The distinction between a Commission Order designated as "Precedential" or "Non-Precedential" has been blurred because all OTC Orders resulting from cases heard by the Office of Administrative Law Judges are now published, not just "Precedential" Orders. *See* OKLA. STAT. ANN. tit.68, § 221(G) (West Supp. 2009) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002). *See also* OTC Orders 2009-06-23-02 and 2009-06-23-03 (June 23, 2009), which also conclude the language of the Statute is "clear and unambiguous."