

JURISDICTION: OKLAHOMA TAX COMMISSION
CITE: 2011-06-30-17 / NON-PRECEDENTIAL
ID: P-10-074-K
DATE: JUNE 30, 2011
DISPOSITION: DENIED
TAX TYPE: SALES
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestants, COMPANY (“Corporation”) and OFFICER (“Officer”); previously represented by REPRESENTATIVE, are represented by ATTORNEY, Attorney at Law, FIRM. The Compliance Division of the Oklahoma Tax Commission (hereinafter "Division"); previously represented by OTC ATTORNEY 1, Assistant General Counsel, is represented by OTC ATTORNEY 2, Assistant General Counsel, and OTC ATTORNEY 3, First Deputy General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

A Convenience Store Gross Sales Computation utilizing the National Association of Convenience Stores 2005 Annual Report of National Averages and Protestants’ beer purchases to determine gross sales during the audit period of July 1, 2006 through June 30, 2009 was performed by the Division. The audit found that Protestants had under-reported their gross receipts. As a result, the Division by letters dated January 15, 2010, proposed the assessment of sales tax, interest and penalty against Protestants in the aggregate amount of \$476,217.53. A timely protest to the proposed sales tax assessments was filed by Protestants. A hearing was not requested.

On March 18, 2010, the Division referred the protest and its file to the Office of the Administrative Law Judges for further proceedings consistent with the Uniform Tax Procedure Code¹ and the Rules of Practice and Procedure before the Office of Administrative Law Judges². The protest was docketed as Case No. P-10-074-K and assigned to ALJ, Administrative Law Judge.³

A pre-hearing conference with respect to the Corporation’s protest was scheduled for May 11, 2010, by *Prehearing Conference Notice* issued April 6, 2010⁴ to the previous representative of Protestants. By *Status Report* filed May 6, 2010, the parties advised that they had met to discuss the protest to the proposed sales tax assessment, that Protestants did not protest the proposed withholding and franchise tax assessments and that Protestants intended to provide the Division with a “complete set of sales tax records and documents for each of the five

¹ 68 O.S. 2001, § 201 et seq., as amended.

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).

convenience stores” operated by Protestants. A continuance of at least forty-five (45) days was requested by the parties. By letter issued May 7, 2010, the parties were advised that the *Status Report* was considered a report in lieu of the pre-hearing conference and that the pre-hearing conference was considered held. The parties were directed to file a status report on or before July 5, 2010.

By *Status Report* filed July 2, 2010, the Division’s representative requested that a scheduling order be issued because the documentation provided by Protestants “was not sufficient to warrant a revision to the proposed sales tax assessment.” On July 21, 2010, a *Scheduling Order and Notice of Hearing* (“*Notice*”) was issued setting forth the procedure by which the protest would be submitted for decision, including the scheduling of a hearing for November 4, 2010. The *Division’s Memorandum Brief* and attached exhibits A through N-2 were filed October 28, 2010.

The hearing was held as scheduled. Neither Protestants’ representative nor Protestants attended the hearing or responded to the *Notice*. As a preliminary matter, the undersigned announced that the hearing would proceed with respect to the Corporation’s protest only, that notice would issue to the Officer with respect to his individual protest and that the decision of the Court would be stayed pending said notification. A letter commemorating the announcement was issued November 5, 2010.

At the November 4, 2010 hearing, the Division called one witness: AUDITOR, Auditor who testified with respect to the records; or lack thereof, provided by Protestants and the conduct of the audit. Exhibits A through N-2 were offered and admitted upon motion of the Division’s representative, and identified by the Auditor. Upon conclusion of the Auditor’s testimony, the record with respect to the Corporation’s protest of the proposed sales tax assessment was closed.

A pre-hearing conference with respect to the Officer’s protest of the proposed sales tax assessment was scheduled for December 1, 2010, by *Prehearing Conference Notice* (“*Notice*”) issued November 5, 2010 to the Officer. Upon motion of the Officer for a continuance, the pre-hearing conference was rescheduled for January 25, 2011, by *Notice of Prehearing Conference* issued December 8, 2010. Pursuant to the rescheduled pre-hearing conference, the parties were directed to file a status report on or before February 15, 2011.

By *Status Report* filed February 15, 2011, the Division submitted the Officer’s executed statement showing the Officer was the President of the Corporation during the audit period and the Officer had no additional documentation to provide to the Division. Based upon these admissions the Division requested that the record be closed and the matter submitted for decision. By *Status Report* filed February 16, 2011, the Division advised that on the afternoon of February 15, 2011, the Officer provided the Auditor Supervisor a box of documents to consider. The Division requested additional time to review the documentation and file a status report. By letter dated February 17, 2011, the parties were directed to file a status report on or before March 10, 2011.

By *Status Report and Request to Close the Record and Submit the Case for Findings of Facts and Conclusions of Law*, the Division advised that the box of documents provided by the

Officer contained binders of invoices only and that upon review of the documents, the Auditor found them to be unreliable. The Officer was notified by letter dated March 10, 2011, that he could file a response to the Division's request on or before March 25, 2011. On March 24, 2011, an *Entry of Appearance and Request for Time* was filed by Protestants' current representative. The *Division's Objection to Protestants' Request for Additional Time* was filed March 24, 2011.

An *Order Denying Request for Time* ("Order") was issued March 30, 2011. The *Order* further decreed that "as of April 1, 2011, the records with respect to these proceedings are closed and the protests are submitted for decision." On April 1, 2011, *Protestant's Position Statement and Brief in Support* ("*Protestants' Statement and Brief*") was faxed to this office. A verification of the facts and Exhibits 1 through 5 were attached to *Protestants' Statement and Brief*. The records were closed and the protests were submitted for decision on April 1, 2011.⁵

FINDINGS OF FACT

Upon review of the file and records, including *Division's Memorandum Brief*, the recording of the hearing, the exhibits received into evidence and *Protestants' Statement and Brief* and attached exhibits, the undersigned finds:

1. The Corporation owned and operated under one sales tax permit (#XXX) several convenience stores during the selected audit period of July 1, 2006 through June 30, 2009, namely: STORE 1 located at STORE 1 ADDRESS in CITY 1, Oklahoma (opened November 15, 2002); STORE 2 located at STORE 2 ADDRESS in CITY 2, Oklahoma (opened December 16, 2003 and closed October 30, 2007); STORE 3 located at STORE 3 ADDRESS in CITY 1, Oklahoma (opened June 27, 2005); STORE 4 located at STORE 4 ADDRESS in CITY 1, Oklahoma (opened June 27, 2005 and closed August 30, 2007); and STORE 5 located at STORE 5 ADDRESS in CITY 1, Oklahoma (opened March 23, 2006). Field Audit Write Up⁶; *Protestant's Statement and Brief*, Statement of Facts, ¶ 2; and *Division's Memorandum Brief*, General Statement of Facts, ¶ 1. Protestants filed consolidated sales tax reports for all the locations. Auditor's testimony.

2. During the audit period, the Officer was President of the Corporation. Division's Exhibit A.⁷ The Officer does not contest that he was a principal officer of the Corporation.

3. The convenience stores offered for sale and sold the typical convenience store products, including fuel, cigarettes and other tobacco products, low-point (3.2) beer, lottery tickets, magazine/news periodicals, candy, soft drinks, snacks, miscellaneous food and other consumer goods/grocery items. Field Audit Write Up; *Protestant's Statement and Brief*, Statement of Facts, ¶ 2; and *Division's Memorandum Brief*, General Statement of Facts, ¶ 1. "At

⁵ OAC, 710:1-5-39(a).

⁶ Accepted as evidence by official notice. OAC, 710:1-5-36.

⁷ The Field Audit Write Up indicates that the Officer was the sole officer of the Corporation; however, Exhibit A (*Business Registration* for the Corporation filed October 16, 2002) shows that at one time, SECRETARY was Secretary of the Corporation.

no time did Protestants sell or offer for sale hot food or other food service items aside from fresh coffee and fountain drinks.” *Protestant’s Statement and Brief, Statement of Facts*, ¶ 2.⁸

4. According to the Auditor, the audit of Protestants’ businesses was generated by a comparison of Protestants’ low-point beer purchases and their reported taxable sales which reflected at least for 2007 that beer purchases were “only slightly” (approximately 3.5 %) less than reported taxable sales. Auditor’s testimony; Field Audit Write Up. The Field Audit Write Up also indicates that an audit lead was written based on the observation of two Oklahoma Tax Commission employees who witnessed during a Compliance Survey numerous cash transactions where a record of the sale (receipt/Z-tapes) was not provided to the customer and/or created. Division’s Exhibit B.

5. Standard records requests dated July 1, 2009 and October 5, 2009 were mailed to the Corporation at its “last-known address⁹.” Division’s Exhibit D. In response to the records requests, Protestants submitted a completed listing of principal officers dated September 9, 2009, income statements for 2006, 2007 and 2008, bank statements for two accounts for the entire audit period and a “small stack of sample purchase invoices”. Auditor’s testimony; Field Audit Write Up; Division’s Exhibit F; and Protestants’ Exhibit 1. According to the Field Audit Write Up and testimony of the Auditor, because Protestants did not provide any information with respect to verifying their daily sales and did not have a comprehensive price list of products sold, an indirect method of calculating Protestants’ gross receipts was utilized. See Division’s Exhibit E¹⁰.

6. Protestants’ audited (expected) gross receipts were calculated under the Convenience Store Gross Sales Computation (“CSGS Computation”) which utilizes the National Association of Convenience Stores 2005 Annual Report of National mark-up Averages and the amount of beer purchased by Protestants as confirmed by the reports of Protestants’ beer wholesalers. Auditor’s testimony; Field Audit Write Up; Division’s Exhibit G; and Protestants’ Exhibits 3 and 4¹¹. The CSGS Computation determined that Protestants had under-reported their sales during the audit period by the amount of \$4,171,897.78. Division’s Exhibit H and Protestants’ Exhibits 2.12 through 2.16.

⁸ The facts alleged in *Protestants’ Statement and Brief* were verified by the Officer of the Corporation.

⁹ 68 O.S. Supp.2009, § 208.

¹⁰ Markup Percentages form dated December 3, 2009. The form shows mark up percentages were listed for all categories except “Food Service” and “Frozen”; however, the form also indicates that Protestants did “not have a comprehensive price list” and “agree the auditor may use the best information available to determine sales, including but not limited to the State or National markup.”

¹¹ Summary of 3.2 Beer Purchase Information from Wholesalers. The Field Audit Write Up indicates that Protestants purchased beer from Premium Beers and Capital Distributing during the audit period. The Summary and Field Audit Write Up show that the information from the wholesalers for 2006 was an annual total which amount was divided in half for purposes of the CSGS Computation.

7. One of the categories of products sold described as a “Department” included in the CSGS Computation is “Foodservice”. The record is completely devoid of any evidence of what this Department consists of. The gross sales for the audit period from this Department as calculated by the CSGS Computation are \$1,060,118.35. See Division’s Exhibit G and Protestants’ Exhibit 4. As noted in ¶ 3 *infra*, Protestants aver that “[a]t no time did Protestants sell or offer for sale hot food or other food service items aside from fresh coffee and fountain drinks.”

8. As a result of the audit, the Division by letters dated January 15, 2010, proposed the assessment of sales tax, interest and penalty against Protestants in the aggregate amount of \$476,217.53. Division’s Exhibits H and L-1; Protestants’ Exhibits 2.12 through 2.16.

9. Protestants timely protested the proposed sales tax assessment; asserting that the use of industry averages for determining cost and sales prices of products sold is arbitrary, that no allowance was made for loss of products due to “shop lifting, employee theft, breakage/spoilage and out of date products” and that the purchase information for beer and its mark up percentage are erroneous. Division’s Exhibit M. Protestants did not request a hearing in the letter of protest. *Id.*

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestants sustained their burden of proving by a preponderance of the evidence that the use of the CSGS Computation to determine their gross sales during the audit period is incorrect; and in what respect.

Protestants contend that the CSGS Computation as applied to them is unreasonable, arbitrary, unreliable, erroneous and not supported by substantial evidence. In support of this contention, Protestants argue that the average margin and product mix within the CSGS Computation are primarily based on data reported by vendors owning between 11 and 500 convenience stores that have greater buying power, available space and more personnel to produce and manage high volume traffic as opposed to their stores. Protestants further argue that the National Association of Convenience Stores 2005 report was meant to be a benchmarking tool for firms with similar characteristics rather than an auditing method. Protestants; in particular, take exception with the amount of gross sales calculated in the Department “foodservice”; arguing that they “did not sell and ha[ve] never sold hot food or food prepared on premises, other than hot and cold dispensed beverages (coffee drinks and fountain drinks) and frozen drinks.” Protestants also argue that the CSGS Computation does not take into account non-taxable sales, including lottery tickets, magazine/new periodicals, sales to 100% disabled veterans, and food stamp sales.

The Division contends that Protestants’ protests to the proposed sales tax assessment must be denied because Protestants failed to come forward with any specific evidence to show the sales tax audit is incorrect. The Division further contends that the audit methodology utilized in this case has been determined to be “not arbitrary”, but “an acceptable ‘indirect’ approach of determining a taxpayer’s gross receipts when the taxpayer’s records are incomplete, unavailable, or non-existent”, citing Oklahoma Tax Commission Order No. 2010-08-17-03.

CONCLUSIONS OF LAW

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

1. Jurisdiction of the parties and the subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. Supp. 2002, § 221(D).

2. The collection and remittance of sales tax is governed by the Oklahoma Sales Tax Code (“Code”).¹² An excise tax is levied upon the gross receipts or gross proceeds 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. The sale of “tangible personal property”¹³ 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).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, (“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. Every tax remitter¹⁵ 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

¹² 68 O.S. 2001, § 1350 et seq., as amended.

¹³ 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.

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

¹⁵ 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.

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 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)¹⁶. The records and books shall cover receipts from all sales and distinguish taxable from nontaxable receipts, and must clearly document all the information (deductions as well as gross receipts) required for the sales tax report. *OAC*, 710:65-3-30(a)(1). See *OAC*, 710:65-3-4(a)(1) and (3).¹⁷

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*¹⁸, 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. 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 and *Kifer v. Oklahoma Tax Commission*, 1998 OK CIV APP 34, 956 P.2d 162.

¹⁶ 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:

- (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.

¹⁷ This rule in general provides that every vendor shall file a monthly report for sales made the preceding month disclosing among other things: (1) total gross receipts for the preceding month from sales, both taxable and non-taxable, and (2) deductions allow by law. Deductions not specifically delineated on the face of the report must be fully explained in the space provided.

¹⁸ 511 S.W. 2d 315 (Tex.Civ.App. 1974).

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. An order of the Tax Commission must be supported by substantial evidence. *Dugger v. State ex rel. Oklahoma Tax Commission*, 1992 OK 105, 834 P.2d 964. Likewise, the audit upon which a portion of the record is formed and order issued, must be supported by substantial evidence. Oklahoma Tax Commission Order No. 2003-07-22-09, 2003 WL 2347117.

An audit is supported by substantial evidence when an evidentiary foundation for the audit has been established. In a majority of cases, the evidentiary foundation will be established by the records reviewed by the auditor. In those cases where an evidentiary foundation for the audit has been established, the taxpayer has the burden of proving in what respect the action of the Tax Commission in assessing the tax is incorrect. OAC, 710:1-5-47; *Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission*, 1988 OK 91, 768 P.2d 359. However, where an evidentiary foundation has not been laid or the records upon which the audit is based do not establish a basis for assessing a tax, the audit and assessment in the initial instance cannot be sustained as being supported by substantial evidence. *Dugger*, supra.

9. Protestants principally attack the audit methodology utilized by the Division to verify Protestants’ gross receipts during the audit period; arguing that the computation is based on data that is not comparable to Protestants’ stores, does not account for non-taxable sales and makes no allowance for loss of product. The CSGS Computation is not arbitrary, but is based on Protestants’ beer purchases, the national average of purchases per category based on the amount of beer purchased (product mix) and the national average mark up percentages for those categories. Vague wide sweeping allegations that the information on which an assessment is based is incorrect is not sufficient to carry the taxpayer’s burden of proving the assessment is incorrect. *Continental Oil Company v. Oklahoma State Board of Equalization*, 1976 OK 23, 570 P.2d 315, 317. Protestants in particular argue that the Department “foodservice” must be removed from the computation because they did not sell prepared food. Protestants argument is inconsequential. No evidence was produced to show what product mix makes up this category. Further, Protestants admit that they sold coffee, and fountain and frozen drinks.

DISPOSITION

THEREFORE, based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protests to the proposed sales tax assessments of Protestants, COMPANY and OFFICER be denied. It is further recommended that the amount in controversy, inclusive of any additional accrued and accruing interest, be found due and owing by Protestants, COMPANY and OFFICER.

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.”