JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2012-07-17-02 / NON-PRECEDENTIAL**
ID: **P-09-219-K / P-09-220-K**
DATE: **JULY 17, 2012**
DISPOSITION: **REMANDED IN PART / DENIED IN PART**
TAX TYPE: **SALES / WITHHOLDING / TOURISM**
APPEAL: **UNDETERMINED**

ORDER

The above matters come 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 28th day of July, 2011, the Commission makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

Upon audit findings of wages paid to employees; and the under-reporting of gross receipts from the operation of three convenience stores during the audit period inclusive of the months of March, 2006 through December, 2008, the Compliance Division by letters dated August 6, 2009, issued proposed sales, withholding and tourism tax assessments against the Company and proposed sales and withholding tax assessments against PROTESTANT as a member of the Company and as an individual; and proposed sales and withholding tax assessments against PROTESTANT as a sole proprietor. The sales tax assessments are based on the Convenience Store Gross Sales Computation utilizing the National Association of Convenience Stores 2005 Annual Report of National Averages and Protestants' beer purchases. The withholding tax assessment for the Company and PROTESTANT as a member is based on two employee positions each working 16 hours per day and one night shift position working 8 hours per day at minimum wage. The withholding tax assessment against PROTESTANT as sole proprietor is based on two employee position per store working 17 hours per day at minimum wage. The tourism tax assessment for the period inclusive of the months of March, 2006 through June, 2007 is a product of the sales tax audit. A timely protest to the proposed assessments was filed by Protestants.

On December 22, 2009, the Division referred the protest and its files 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 Administrative Law Judges[2]. The protest was separated and docketed as Case No. P-09-219-K and P-09-220-K and each assigned to ALJ, Administrative Law Judge.[3]

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[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).

A pre-hearing conference was scheduled in each case for February 9, 2010, by *Prehearing Conference Notices* issued January 21, 2010.[4] Pursuant to the *Report in Lieu* filed February 3, 2010, the parties were directed by letter issued February 5, 2010, to file a status report on or before March 5, 2010.

Pursuant to the joint *Request for Hearing* filed July 22, 2010, an *Order Granting Request for Hearing* was issued scheduling a hearing in the consolidated matters for September 23, 2010. An *Order Granting Motion for Leave to Withdraw and Notice to Protestants of a Scheduled Hearing* was issued September 8, 2010, upon the *Motion for Leave to Withdraw* filed by Protestants' former counsel. An *Order Granting Request to Extend Hearing Date* was issued September 13, 2010, scheduling the hearing in the consolidated matters for December 14, 2010. The hearing was continued to January 26, 2011, by *Order Granting Request to Extend Hearing Date* issued November 17, 2010.

A closed hearing[5] was held as rescheduled. As a preliminary matter, the parties agreed to stipulate to the following: (1) "to the store names, the locations and the ownership"; (2) "that * * * PROTESTANT is liable for the sales tax assessed against all convenience stores as a member of one of the convenience stores, * * * and as an individual, and also as the owner of [the other two convenience stores]"; (3) "that the burden of proof is on the Protestant[s]"; (4) "that [PROTESTANT], * * * sold all these stores in 2008 before the notice of the audit"; and (5) "that no Z tapes were submitted at the time of the audit, but there were some purchase invoices, bank statements and copies of checks submitted by the Protestants during the audit". Tr. 8. PROTESTANT testified with respect to the operations of the stores and identified the records obtained from the subsequent owners of the stores. Exhibits 3-A through 3-K were identified, offered and admitted into evidence. CPA, Certified Public Accountant testified with respect to his review of the methodology used by the Division to assess sales taxes against Protestants. Exhibits 9-A through 9-R; 5-A through 5-F; and 7-A through 7-F were identified, offered and admitted into evidence. AUDITOR, Auditor testified with respect to the conduct of the audits and the reasons for the methodology used. SUPERVISOR, Audit Supervisor testified with respect to the reasons for and development of the sales tax audit methodology. Exhibits B-1 and B-2; C-1 through C-3; D-1 and D-2; F-1; E-1 and E-2; J-1 and J-2; G-1 and G-2; K-1 and K-2; and J-4 were identified, offered and admitted into evidence. Upon conclusion of the testimony, the parties were directed to file proposed findings of fact and conclusions of law. On March 4, 2011, the *Compliance Division's Proposed Findings of Fact and Conclusions of Law* and *Protestants' Post-Trial Proposed Findings of Facts and Conclusions of Law* were filed. On May 11, 2011, the records were closed and the protests were submitted for decision.[6]

FINDINGS OF FACT

Upon review of the file and records, including the transcript of the hearing, the exhibits received into evidence and the pleadings of the parties, the undersigned finds:

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

[5] Confidentiality of the proceedings was invoked. 68 O.S. 2001, § 205, as amended.

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

1. During the audit period[7], Protestants' owned and operated three (3) convenience stores, described as "mom and pop, small stores". Tr. 13; 34. One of the convenience stores STORE 1 ("STORE 1") was located in CITY A at the junction of HIGHWAY 1 and HIGHWAY 2. The other two convenience stores STORE 2 ("STORE 2") and STORE 3 were located in CITY B at opposite corners of the intersection of INTERSECTION. Tr. 35-36.

2. STORE 1 was open 24 hours per day seven (7) days per week. Tr. 26. PROTESTANT testified that the hours of operation were 7:00 a.m. to 10:00 p.m. seven (7) days per week for STORE 2 and 7:00 a.m. to 11:00 p.m. for STORE 3. Tr. 27. The audit write up for STORE 2 and STORE 3, and the auditor's testimony indicates each store was open from 7:00 a.m. to 12:00 p.m. seven (7) days per week. Note 7; Tr. 108.

3. PROTESTANT worked at STORE 1 approximately 10 to 12 hours per day 7 days a week. Tr. 26. PROTESTANT testified that "most of the time" two other employees worked approximately 40 hours per week at STORE 1. Tr. 27. PROTESTANT filled in at the other two stores when needed. Tr. 40.

4. The withholding tax audits were conducted because employees were paid mostly in cash, adequate records to support the amount of reported withholding were not provided and mathematically Protestants could not have operated the store without additional help. Tr. 108; 122; 127; note 7.

The STORE 1 audit write-up indicates Protestants had three full time employees, and no contract laborers. Note 7. See Tr. 123. Protestants' average monthly reported withholding to the Oklahoma Tax Commission approximated $60.00 to $70.00 and Protestants' partnership return reported a deduction for wages paid of $24,460.00 and $19,425.00 for tax years 2006 and 2007, respectively. Exhibit G-2; Tr. 120; note 7. The withholding tax adjustment for STORE 1 is based on two employee positions each working 16 hours per day and one night shift position working 8 hours per day at minimum wage, seven (7) days per week, 365 days per year multiplied by five percent (5%). Exhibits G-2 and H-2; note 7. The five percent (5%) is a standard used by the Oklahoma Tax Commission for withholding. Tr. 111; 118. The audited gross wages for STORE 1 were $189,909.00 ($9,495.45/.05) for the audit period. Note 7. By comparison, the BizStats[8] estimation of gross wages based upon STORE 1's annual sales is $484,412.67. Note 7.

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[7] March, 2006 through December, 2008. Field Audit Write-up[s], of which official notice is taken. *OAC*, 710:1-5-36. Although the stores were sold in November, 2008, the audit period was extended to include December, 2008 because the purchaser or purchasers continued to operate the stores under the sales tax permits of Protestants. Tr. 88-89. The audit write-ups reflect the STORE 3 and STORE 2s stores were sold on October 31, 2008 and the STORE 1 store was sold on December 5, 2008. Also, the audit files received from the Division contain Assessment and Refund Statute of Limitation Waiver Agreements executed by PROTESTANT and the auditor which extended the period for the assessment of sales, use, tourism and withholding taxes to September 30, 2009, of which official notice is taken. *OAC*, 710:1-5-36.

[8] Described as "a web site that provides free industry statistics reports, including, profit and loss statements that include salaries and wages based upon a stores annual sales." Note 7.

The STORE 2 and STORE 3 audit write-up indicates PROTESTANT's spouse and son[9], and one part-time employee helped him operate the two stores. PROTESTANT did not employ any contract laborers. Note 7. The total amount of withholding reported for the two stores during the audit period was $269.49. Exhibit I-2. A deduction for wages paid was not reported on PROTESTANT's income tax returns for tax years 2006 and 2007. Note 7. The withholding tax adjustment for the two stores is based on two employee positions per store working 17 hours per day at minimum wage, seven (7) days per week, 365 days per year multiplied by five percent (5%). Exhibit G-1; Tr. 108-110. The audited gross wages for STORE 2 and STORE 3 were $381,883.80 ($19,094.15/.05) for the audit period. Note 7. By comparison, the Bizstats estimation of gross wages based upon STORE 2's and STORE 3's annual sales is $374,315.32. Note 7.

5. PROTESTANT was not included in the withholding tax audit calculations. Tr. 121.

6. As a result of the withholding tax audit of STORE 1, the Division by letters dated August 6, 2009, assessed an aggregate amount of $13,125.82 against the Company and PROTESTANT as a member of the company, consisting of tax in the amount of $9,495.45, interest accrued through August 31, 2009, in the amount of $2,680.80 and penalty in the amount of $949.57. Exhibit J-3[10].

7. As a result of the withholding tax audit of STORE 2 and STORE 3, the Division by letter dated August 6, 2009, proposed the assessment of withholding tax, interest and penalty against PROTESTANT in the aggregate amount of $26,978.16, consisting of tax in the amount of $19,090.19, interest accrued through September 30, 2009, in the amount of $5,978.92 and penalty in the amount of $1,909.05. Exhibit K-2; Tr. 112.

8. Protestants sold the typical convenience store merchandise at all three locations, inclusive of gasoline[11], soda, beer, cigarettes, canned food, chips, candies and lottery tickets. Tr. 14. Protestants also had a self serve soda fountain and coffee maker, and sold prepared foods such as burritos and pizzas at the STORE 1 location. The audit write-up for the other two locations indicates that "a place for the customer to consume hot foods" was not provided.[12] See note 7. PROTESTANT testified that the average daily gross inside sales were $1,200.00 to $1,500.00 for STORE 2 and STORE 3, and $1,800.00 to $2,000.00 for STORE 1. Tr. 14.

9. Protestants' major wholesalers were VENDOR A, VENDOR B, VENDOR C, VENDOR D, VENDOR E, VENDOR F, VENDOR G, VENDOR H and VENDOR I. Tr. 90-91. Protestants provided copies of purchase invoices from VENDOR J., VENDOR K, VENDOR L and several miscellaneous vendors that the auditor scheduled. Tr. 93-94. According to the

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[9] PROTESTANT's son operated his own convenience store during the audit period. Note 7.

[10] Withholding tax assessment issued against PROTESTANT as a member of the Company. The file received from the Division contains a copy of the withholding tax assessment issued against the Company, of which official notice is taken. *OAC*, 710:1-5-36

[11] Note 7.

[12] This is the reason given for not conducting a tourism tax audit for these two locations.

auditor, the purchase invoices were incomplete, not useful and a majority consisted of cigarettes and other tobacco products which are not subject to sales tax. Tr. 92-94.

10. Protestants did not provide records of their lottery sales. Tr. 116.

11. Protestants accepted food stamps at all three locations. Tr. 14-15; 33; 37-39; note 8. PROTESTANT testified that food stamp sales at the two locations in CITY B averaged approximately $7,500.00 per month and at STORE 1 approximately $2,000.00 per month. Tr. 14-15; 38-39. Protestant kept track of the food stamp sales through the use of Z-tapes. Note 7. Protestants' employees accepted food stamps for the purchase of beer. Tr. 38. Protestants did not provide records of exempt food stamp sales and did not seek records of their exempt food stamp sales from the Oklahoma Department of Health Services. Note 7; Tr. 115; 33.

12. Protestants experienced losses of cigarettes and beer through theft and were robbed of cash a couple of times at the locations in CITY B. Tr. 36. Protestants did not provide any police reports, insurance claims or anything else to show that his supplies, sundry items or 3.2 beer was stolen. Tr. 89. Protestants also did not provide records of their fluctuation in inventory due to spoilage or loss. Tr. 116.

13. Pursuant to the audit notification, a records request was issued for all three stores. Exhibits B-1 and B-2; Tr. 84-85. In response to the records request, Protestants provided "some bank statements", a "few 941s" and the sales agreement for the stores. Tr. 87-88. Because Protestants did not provide the requested information, subpoena duces tecums were issued for all the stores. Exhibits C-1 and C-2; Tr. 89. In response to the subpoenas, Protestants provided "some invoices" and "some 941s". Tr. 89. A schedule of the invoices which did not included Protestants' major wholesalers was created. Exhibit C-3; Tr. 91. The schedule of purchase invoices was incomplete, not useful and a majority consisted of cigarettes and other tobacco products which are not subject to sales tax. Tr. 92-94.

14. The stores were sold prior to the audit notification. Tr. 8; 20-22. PROTESTANT testified that he left the paperwork at each store upon the sale thereof so that the new owner could show taxes were paid on the other tobacco products. Tr. 21. Upon notification of the audit, PROTESTANT went to each location to obtain the paperwork and was told that it had been thrown away. Tr. 21. The audit write-ups indicate that PROTESTANT "does not know what happened to the cash register receipt tapes after the stores w[ere] sold" and that Protestants "did not keep a general ledger, purchase invoices, and/or sales journals." Note 7.

15. A comparison of Protestants' gross receipts utilizing information from Protestants/PROTESTANT's federal income tax returns, bank statements and sales tax reports show that they do not match. Exhibits D-1 and D-2. Bank statements for every month of the audit period were not provided. Id.; Tr. 101-102. According to the auditor, a comparison of bank deposits to sales tax reports show not all money was deposited into Protestants' bank accounts. Tr. 102. The auditor further testified that PROTESTANT admitted to paying his vendors in cash. Tr. 102.

16. A comparison of Protestants' sales tax reports to beer purchases indicates that taxable sales were substantially understated since beer purchase costs exceeded Protestants' reported taxable sales each year. Note 7; Exhibits D-1 and D-2; and F-1 and F-2.

17. According to the audit write-ups and testimony of the auditor, due to weak internal controls, lack of source documents and the un-reliability of the documents provided, an indirect mark-up method was utilized to audit Protestants' sales. Note 7; Tr. 94; 101-102. Further, because Protestants did not provide a comprehensive list of costs and sales prices for the products sold, the auditor defaulted to the national averages. Note 7.

18. Protestants' audited (expected) gross receipts were calculated under the Convenience Store Gross Sales Computation ("CSGS Computation") which utilizes the National Association of Convenience Stores ("NACS") 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. Exhibits E-1 and E-2; F-1 and F-2; Exhibits 1-A through 1-I; and Tr. 106 and 113-114. The audited gross sales for the audit period were calculated to be $3,114,778.85 for STORE 1 and $2,584,417.39 for STORE 2 and STORE 3. Exhibit H-1 and I-1.

19. As a result of the sales tax audit of STORE 1, the Division by letters dated August 6, 2009, assessed an aggregate amount of $353,824.96 against the Company and PROTESTANT as a member of the company, consisting of tax in the amount of $267,870.98, interest accrued through August 31, 2009, in the amount of $59,166.89, and penalty in the amount of $26,787.09. Exhibits J-1 and J-2[13].

20. As a result of the sales tax audit of STORE 2 and STORE 3, the Division by letter dated August 6, 2009, proposed the assessment of sales tax, interest and penalty against PROTESTANT in the aggregate amount of $293,544.62, consisting of tax in the amount of $216,444.95, interest accrued through September 30, 2009, in the amount of $55,455.18 and penalty in the amount of $21,644.49. Exhibit K-1.

21. The Division by letter dated August 6, 2009, also proposed the assessment of tourism tax, interest and penalty against the Company in the aggregate amount of $122.47, consisting of tax in the amount of $84.11, interest accrued through August 31, 2009, in the amount of $29.95, and penalty in the amount of $8.41. Exhibit J-4. The tourism tax assessment includes only the months of March, 2006 through June, 2007, and is "based on the markup results from categories identified as selling items in which sales tax was applicable." Note 7.

22. Protestants timely protested the proposed assessments. Exhibits L; and 3-A through 3-K.

23. CPA testified that but for cigarette and other tobacco product sales, the CSGS Computation does not account for non-taxable in-side sales such as items purchased with food stamps, lottery sales, phone cards and sales to disabled veterans; Tr.46-47; 62-64, that the CSGS

[13] The assessment contains a typographical error listing interest as accrued through May 11, 2009 rather than August 31, 2009. See Exhibit J-1.

Computation does not account for inventory fluctuations nor shrinkage or spoilage; Tr. 46; 62, and that the CSGS Computation assumes that everything that is purchased is sold and is subject to sales tax; Tr. 63.

24. CPA identified Exhibits 9-A through 9-R[14] as the documents used by the Division to produce the percentages, mark-up and product mix in the CSGS Computation. Tr. 47. The Division utilized the 2003 State of the Industry Highlights from the NACS'2004 Annual Report to produce margin percentages and a combination of the 2003 report and 2005 report to produce product mix percentages. Tr. 47-48.

25. NACS annual reports are based on the self-reported numbers from the annual surveys of its member firms. Tr. 50. The vast majority of respondents to the 2008 and 2009 annual survey were firms operating more than 200 convenience stores. 1.3% percent of the respondents were firms operating less than 10 convenience stores. Exhibits 5-A and 5-D; Tr. 51-52; and 55-56. According to CPA, large chain store firms are more profitable because they can "combine quantity" to secure discounts small chain store firms can not get. Tr. 51. He further stated that the use of the CSGS Computation based on the NACS survey to audit small chain store firms is not appropriate because the survey is skewed towards large more profitable firms. Tr. 56.

26. The 2008 and 2009 NACS State of the Industry survey acknowledges that the respondents to the survey are "mature operations with more extensive offerings" versus the broader range of performers, that they typically perform at a higher level than the national average, and that the "sample is generally from companies with a higher level of operating profits". Exhibits 5-A through 5-F; Tr. 54-55. However, the NACS survey further provides that "survey responses from participating firms were weighted using factors to normalize reported data to the composition of the industry" and "NACS believes the number of responses and the quality of reported data to be reflective of the overall industry". Exhibits 5-A and 5-D.

27. According to CPA the audited gross receipts are not correct because the CSGS Computation: (1) does not factor in any adjustments for non-taxable sales besides cigarettes and other tobacco products, and (2) does not conform to a small store environment. Tr. 64.

28. SUPERVISOR testified that the Division created the product mix and margins contained within the CSGS Computation used by the Division to audit convenience stores. Tr. 137. She stated that the Division uses product margins in the calculation rather than profit margins because product margins do not vary as much. Tr. 144. She further stated that the 21.11% mark-up for beer was calculated using combination of information from the 2004, 2005 and some 2003 NACS State of the Industry reports. Tr. 137-138. She further testified that NACS does not consider lottery tickets as part of the merchandise of a convenience store and so lottery sales are not part of the percentages. Tr. 143. SUPERVISOR also testified that NACS information takes into consideration different sizes of convenience stores by square footage and the NACS percentages are based on a weighted average. Tr. 131.

[14] Exhibit 9-F is not contained in the Exhibit.

29. Protestants provided an alternative assessment computation. Exhibits 7-A through 7-F. The Exhibits are a calculation of the stores annual under-reported sales based on information provided by PROTESTANT to his bookkeeper who compiled the numbers. Tr. 18-19. The Exhibits indicate that the calculations are based on "actual 3.2 beer purchases, est. grocery purchases and [Protestants'] markup percentages" which markup percentages were "determined by approximate actual product sale price". Exhibits 7-A through 7-F. The percentages of sales for each category listed to beer sales reflect they are set on average sale of those items. Id.

ISSUE AND CONTENTIONS

During the hearing, Protestants' counsel indicated there was "to a certain degree" a dispute with the withholding tax proposed assessments issued against Protestants. Neither the letter identified as the protest, the pre-trial brief, opening statement of counsel nor post-trial pleading raises any issue with respect to the proposed withholding tax assessments. Issues not raised or clearly identifiable will not be addressed. See, 68 O.S. Supp. 2002, § 221(C)(2).

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 or receipts during the audit period is incorrect; and in what respect.

Protestants do not deny that proper records were not produced; and that absent proper records, an indirect method to determine total taxable sales and sales tax owed; if any, must be utilized. Protestants contend that the CSGS Computation method is unreliable, erroneous and not supported by substantial evidence. In support of this contention, Protestants argue that the Division is unable to produce the source data used to calculate the product mix and mark-up percentages of the CSGS Computation and thus the proposed sales tax assessments are not supported by substantial evidence. Protestants further contend that the use of national average mark-up/margin and product mix as applied to Protestants businesses is unreasonable, arbitrary, capricious, and does not meet the required substantial evidence standard. In support of this contention, Protestants argue that the national averages are primarily based on data reported by vendors owning between 11 and 500 plus convenience stores which have greater buying power, available space and more personnel to produce and manage high volume traffic as opposed to their stores. Protestants further contend that the proposed sales tax assessments are erroneous because 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 assessments must be denied because Protestants failed to come forward with any specific evidence to show the sales tax audits are incorrect. In support of this contention, the Division argues that the audit methodology utilized in this case is an acceptable indirect method 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. The Division also argues that Protestants have not come forward with any evidence to substantiate their non-taxable sales; if any, and that Protestants have not done anything more than speculate and assume what their sales and exemptions were, or might have been, for the audit period.

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").[15] 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"[16] 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).[17] 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 remitter[18] 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 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,

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[15] 68 O.S. 2001, § 1350 et seq., as amended.

[16] 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.

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

[18] 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.

§ 1365(F). See *OAC*, 710:65-3-31(a)[19]. 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).[20]

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*[21], 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.

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.

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[19] 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.

[20] 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.

[21] 511 S.W. 2d 315 (Tex.Civ.App. 1974).

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. Although the Tax Commission is not required to comply with provisions of the Administrative Procedures Act ("APA"),[22] including those which address judicial review of final agency orders, the due process standards embodied therein apply to all state agencies, including the Tax Commission.[23]

10. Taking of one's property by legal process, including assessment of taxes against an individual in his personal capacity, is a protected interest to which due process is applicable.[24]

11. Procedural due process of law contemplates a fair and open hearing before a legally constituted court or other authority with notice and opportunity to present evidence and argument, representation by counsel, if desired, and information concerning the claims of the opposing party with reasonable opportunity to controvert them.[25]

12. Failure to provide notice of the specific issues in administrative hearings violates procedural due process.[26]

DISCUSSION AND ORDER

The taking of one's property by legal process, including assessment of taxes, is a protected interest to which due process is applicable. Procedural due process of law contemplates a fair and open hearing with notice and opportunity to present evidence and argument and information concerning the claims of the opposing party with reasonable

[22] OKLA. STAT. ANN. tit. 75, § 250 *et seq.* (West 2002).

[23] *Grasso v. Oklahoma Tax Com'n*, 2011 OK CIV APP 37, 249 P.3d 1258. (Citations omitted.)

[24] *Id. See* U.S. CONST. amend. XIV. (Citations omitted.)

[25] *Id.*

[26] *Id.*

opportunity to controvert them.[27] The failure of the Division, when requested by the taxpayer, to timely disclose and provide to protestant the supporting documentation upon which its audit methodology is based raises serious due process concerns.

The evidence in this matter establishes, and protestants concede, that the protestants did not keep all of the records required by statute[28] or by Tax Commission Rule[29]. When taxpayer records are not complete or not reliable the Commission recognizes that the Division may need to use an alternative methodology to determine the amount of tax owed. The objective of the Division in computing a proposed assessment must always be to arrive at the most accurate amount of tax owed. There must be a substantial basis underlying the estimates in any methodology used by the Division. Adjustments to the estimates, or to the methodology, may be warranted based on the distinct and identifiable characteristics of an individual business as compared to the characteristics of the businesses underlying the estimates used in the alternative methodology. Adjustments to the estimates, or to the methodology, should be made when an individual taxpayer can provide sufficient evidence that would justify adjusting the estimates used in the audit. The taxpayer must always be afforded Due Process in the conduct of the audit.

Comparison between the results obtained by using an alternative methodology and the results obtained by using taxpayer records may indicate that an adjustment to the alternative methodology is warranted. Adjustments to the amount of taxable sales estimated by an alternative methodology may be warranted where there is no reasonable relationship between such estimates and estimates obtained by using such records as may be provided by a taxpayer. The amount of adjustment warranted should be based on the reliability and amount of taxpayer records furnished and the degree by which the alternative methodology estimate deviates from estimates derived from taxpayer records. Adjustments may also be warranted based on the distinct and identifiable characteristics of an individual business as compared to the characteristics of the businesses underlying the estimates used in the alternative methodology. The unique situation of individual retailers related to their product mix and the size of their stores should be considered when attempting to determine the amount of tax owed.

The testimony and documentary evidence in this case causes serious concern that the audit methodology used in this case overstates the actual taxable sales of the protestants. The appropriateness of using results of a survey wherein 66.4% of the firms surveyed owned 500+ stores and applying those survey results to stores owned by much smaller firms can reasonably be questioned. The 2008 NACS Annual Report indicates that the average convenience store is 2,696 square feet. If there is evidence that the size of the store involved can be expected to affect either the margin or the product mix then the methodology may need to be adjusted. This order is not intended to set out all of the possible reasons why the alternative audit methodology should be adjusted. Evidence furnished by a taxpayer which would reasonably indicate that the audit methodology may be inaccurate should be considered, including in this instance, evidence of the amount of taxable sales of a successor business in the same location.

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[27] *See* Conclusions of Law 9-12.

[28] OKLA. STAT. ANN. tit. 68, § 1365 (West 2008).

[29] OKLA. ADMIN. CODE § 710: 65-3-31.

In these cases, because of the due process concerns raised by the conduct of the audits, and based on the specific facts and circumstances of these cases, these matters are remanded to the Office of the Administrative Law Judge with directions that the Compliance Division be ordered to revise the assessments of sales taxes and tourism taxes in a manner not inconsistent with this order. Protestants should be afforded the opportunity to respond to such revised assessments.

The protest to the withholding tax assessment is 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.

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."