JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2012-07-17-03 / NON-PRECEDENTIAL**
ID: **P-10-038-K**
DATE: **JULY 17, 2012**
DISPOSITION: **REMANDED TO ALJ**
TAX TYPE: **SALES**
APPEAL: **UNDETERMINED**

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 31st day of August, 2011, the Commission makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

A sales tax audit of Protestant's business for the period inclusive of the months of January, 2007 through July, 2009 was performed by the Compliance Division of the Oklahoma Tax Commission utilizing the Convenience Store Gross Sales Computation. As a result of the audit, the Division by letter dated November 16, 2009 proposed the assessment of additional sales tax, interest and penalty against Protestant. Protestant timely protested the proposed assessment by letter dated December 15, 2009.

On February 4, 2010, the protest file 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 Administrative Law Judges[2]. The protest was docketed as Case No. P-10-038-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for March 24, 2010, by a *Prehearing Conference Notice* issued March 1, 2010.[4] Pursuant to the *Report in Lieu of Appearance*, the conference was considered held and the parties were directed to file a status report.

Pursuant to a *Status Report* filed July 15, 2010, a hearing was scheduled for August 31, 2010, by *Notice of Hearing* issued August 3, 2010. The hearing was stricken and rescheduled for October 12, 2010, by *Order Granting Motion for Continuance* issued August 25, 2010. Upon oral motion of Protestant's counsel, the hearing scheduled for October 12, 2010, was stricken and rescheduled for December 15, 2010. By *Request to Strike* filed December 13, 2010, the hearing scheduled for December 15, 2010 was cancelled and the parties were directed to file

[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).

a status report. Upon *Status Report* filed April 14, 2011, a hearing was scheduled for May 23, 2011, by *Notice of Hearing* issued April 26, 2011.

A closed hearing[5] was held as scheduled. As a preliminary matter, the Division's *Motion in Limine to Exclude Expert Testimony* was denied. ACCOUNTANT, Protestant's accountant testified with respect to the services he provides to Protestant and his understanding of the industry. Protestant's Exhibit 1 was identified and admitted into evidence. AUDITOR, Auditor testified in regard to the records she reviewed, the conduct of the audit and the reasons for utilizing the Convenience Store Gross Sales Computation. Protestant's Exhibit 3 and Division's Exhibits A through H were identified and admitted into evidence. Protestant's husband, HUSBAND testified regarding the operation of the business, the records provided to the Division and the sampling of mark-up percentages. Protestant's Exhibits 2 and 4 were identified and admitted into evidence. AGENT, Enrolled Agent testified with respect to his analysis of the records and calculation of Protestant's unreported sales. Protestant's Exhibit 5 was identified and admitted into evidence. MANAGER, Revenue Unit Manager testified with respect to the reason for the emphasis of auditing convenience stores. Upon conclusion of the testimony, the record was closed and the protest was submitted for decision.[6]

FINDINGS OF FACT

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

1. At all times relevant[7], Protestant owned and operated a small convenience store known as STORE in the old town portion (business district) of CITY, Oklahoma. Testimony of HUSBAND.

2. The hours of operation were 6:30 a.m. to 10:00 p.m., seven (7) days a week/365 days a year. Testimony of HUSBAND.

3. The store has one manual cash register. Testimony of HUSBAND.

4. The store has four (4) fuel pumps and sells the usual assortment of merchandise, including 3.2 beers, magazines, cigarettes and other tobacco products, lottery tickets, soft drinks, fresh coffee and fountain drinks, snacks, and other grocery items. Field Audit Write Up[8]; Testimony of HUSBAND.

5. Except as noted in paragraph 4, Protestant did not sell prepared foods, such as burritos, pizza, hot dogs or donuts. Testimony of HUSBAND.

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

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

[7] The audit period includes the months of January, 2007 through July, 2009.

[8] Evidence by official notice. *OAC*, 710:1-5-36.

6. Notification of the audit was commence with a records request. Division's Exhibit A.

7. In response to the records request, Protestant provided a box of records, including Schedule C - Profit or Loss from Business- to the Federal Income Tax Returns for tax years 2007 and 2008, Division's Exhibits B and C; Profit or loss/Income statements for the entire audit period, Protestant's Exhibits 1 and 6; purchase invoices from VENDOR A, VENDOR B, VENDOR C, VENDOR D, VENDOR E, VENDOR F, VENDOR G, VENDOR H, VENDOR I, VENDOR J, VENDOR K, VENDOR L, VENDOR M, VENDOR N, VENDOR O, VENDOR P, VENDOR Q, VENDOR R and VENDOR S, Division's Exhibit B; Bank Statements for May and June, 2008, August through October, 2008, and January through July, 2009, Division's Exhibit B; Daily Sales Reports for March, 2008, and January through July, 2009, Division's Exhibit B; Food Stamp Purchases, Division's Exhibit B; and Z tapes for January through July, 2009. Testimony of AUDITOR.

8. ACCOUNTANT testified that he prepared Protestant's monthly income statements for the periods beginning with January, 2009 based on the information provided by Protestant which included Protestant's daily receipts report and purchase invoices. Protestant's Exhibit 1. He stated that based on his knowledge of the industry, Protestant's sales were consistent with other convenience stores of the same size. Referring to Protestant's Exhibit 2, ACCOUNTANT agreed that 15% represents a maximum mark-up for beer and 30% represents a maximum mark-up for grocery items.

9. HUSBAND testified that they provided all of the purchase invoices they had to the auditor and that he could not recollect receiving a purchase invoice from a vendor that was not provided. HUSBAND also testified that a purchase invoice could have been inadvertently thrown away and that it is hard to keep track of all invoices.

10. AUDITOR testified that she prepared a summary of Protestant's sales taxable items by month from the purchase invoices. Division's Exhibit B; Protestant's Exhibit 3. She stated that she is not sure whether she received all of Protestant's purchase invoices because the records reflect fluctuation with some vendors where Protestant made purchases for some months and then the purchases trailed off. She further stated that it is possible that Protestant did not purchase anything from those vendors during those months.

11. AUDITOR also testified that when she created the summary of Protestant's purchase invoices she believed the purchase invoices from VENDOR R for the months she made the notation "missing" were not included in the records; however, she agreed that the profit/loss statements on front of the jacket for those months reflect purchases from VENDOR R and the invoices were included in the jacket. She stated that if the invoices were included in Protestant's records at the time she created the summary her notation that the invoices were missing would be inaccurate. She further agreed that if all of Protestant's purchase invoices were provided she could calculate Protestant's taxable sales based on a worst case scenario mark-up percentage. HUSBAND testified that the records provided to the Division have not been changed.

12. HUSBAND testified that he created Protestant's Exhibit 4 which is a list of products they sell the most of and the mark-up percentage for those items. He stated that he cannot

provide a list of all of items sold in the store with purchase invoices and the mark-up percentage because it would involve too much and the price of some of the items would change by the time he finished the list. He admitted that he was asked to provide a detailed list of items for sale with the cost and retail price of the items so that the auditor could do a shelf check, but did not because there is no time to do it. He further admitted that he did not provide the auditor with his lottery or fuel purchase invoices. He further testified that Protestant's Exhibit 2 represents the worst case scenario of what they under-reported during the audit period and the amount of sales taxes they owe, that the grocery mark-up of 30 percent represents the maximum mark-up percentage of the items included in that category and that Protestant did not have anywhere close to $600,000.00 in sales during the audit period as shown by the Division's calculation.

13. AGENT testified that he prepared the "Calculation of Unreported Sales" (Protestant's Exhibits 2 and 5) using the beer wholesalers' reports of beer purchases multiplied by a maximum mark-up of 15% and the grocery purchases from the list compiled by the auditor multiplied by a maximum mark-up of 30%. He testified that the fact that Protestant's records of beer purchases and the wholesalers' reports were less than a $1,000.00 off indicates Protestant's records were fairly accurate. He further stated that his analysis of Protestant's unreported sales is more accurate since he used Protestant's actual purchases and mark-ups.

14. AGENT'S calculation shows Protestant had unreported sales of $76,516.82 during the audit period and owes additional state and city sales taxes in the amount of $6,503.93. Protestant's Exhibits 2 and 5. In reference to the "Calculation of Unreported Sales", AUDITOR testified that the unreported sales approximate 46% of Protestant's reported sales and that this percentage indicates more than an occasional error in reporting.

15. In explaining why she defaulted to the Convenience Store Gross Sales Computation ("CSGS Computation"), AUDITOR testified that Protestant's records were unreliable because Protestant's costs of sales taxable items exceeded the reported sales and Protestant's records were incomplete because Z-tapes were not provided for the entire audit period. AUDITOR also testified there were other anomalies, including the fact that the income statements did not match other records. AUDITOR further testified that if a taxpayer has complete records, the Division will audit those records. She stated that the Division hasn't acquired sufficient information, nor has Protestant done enough in this case to deviate from the CSGS Computation. She further stated with respect to Protestant's Exhibit 4 that she has not seen any back-up documentation of the wholesale prices or mark-ups and that she cannot be certain whether it is statistically reliable.

16. Pursuant to the CSGS Computation, Protestant's unreported sales for the audit period totaled $606,895.59. Division's Exhibits E and F.

17. As a result of the audit, the Division by letter dated November 16, 2009, proposed the assessment of additional sales tax, interest and penalty against Protestant for the audit period in the aggregate amount of $62,033.53, consisting of tax in the amount of $48,551.64, interest accrued through January 31, 2010, in the amount of $8,626.73, and penalty in the amount of $4,855.16. Division's Exhibit G.

18. Protestant timely protested the proposed assessment. Division's Exhibit H.

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestant sustained her burden of proving by a preponderance of the evidence that the audit and resulting assessment are incorrect; and in what respect.

In the position letter filed August 23, 2010, Protestant contends that she reported and paid the proper amount of sales tax for the audit period based on the sales tax reports prepared by her accountant from the sales reports run at the store. Further, Protestant contends that her mark-up percentage is not the same as the national averages used by the Division.

At the hearing, Protestant concedes that she owes additional sales tax for the audit period based on a "worst case scenario" mark-up percentage, but contends the Division's audit is incorrect because it is not based on her records or mark-up percentages.

The Division contends that Protestant failed to provide complete records for the audit period and as a result it utilized the CSGS Computation to determine her taxable sales. Further, the Division contends that Protestants failed to come forward with any specific evidence to show the audit is 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.

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 are 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").[9] 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.

[9] 68 O.S. 2001, § 1350 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).

4. Every tax remitter[12] 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, § 1365(F). See *OAC*, 710:65-3-31(a)[13]. 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).[14]

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[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.

[12] 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.

[13] 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.

[14] 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-

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*[15], 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.

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

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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.

[15] 511 S.W. 2d 315 (Tex.Civ.App. 1974).

the initial instance cannot be sustained as being supported by substantial evidence. ***Dugger***, supra.

DISCUSSION AND ORDER

A proposed assessment is presumed correct and the taxpayer bears the burden of showing by a preponderance of the evidence that it is incorrect, and in what respect. The proposed assessment estimated total taxable sales by using records of protestant's beer purchases obtained from her suppliers and estimates of national averages of markup and product mix percentages taken from trade association publications. As evidence that such estimates were incorrect the protestant furnished what she claimed to be all of her purchase invoices for the audit period. The Division expressed a reluctance to use these records because it could not be assured that all of the purchase invoices for the audit period had been furnished.

The purchase invoices furnished by protestant for her beer purchases were 99.4% of the total the Division calculated using records obtained by the Division from protestant's suppliers. There was no evidence presented that the purchase invoices furnished by protestant for grocery purchases of items other than beer were less accurate than the purchase invoices furnished by protestant for beer purchases. The weight of the evidence in this matter for using the protestant's purchase invoices to estimate protestant's purchases is greater than the weight of the evidence for using estimates of national averages taken from trade publications to estimate protestant's purchases.

In order to arrive at an estimate for taxable sales when a usable estimate of purchases is present the Division must apply some percentage of markup. In this case the Division used estimates of national averages of markup for various product categories taken from trade association publications. Protestant asserted these markups were too high and proposed a "worst case" estimate of taxable sales using her own assertion of the "worst case" markup for beer and for other grocery items. The only evidence that these were indeed the "worst case" markups was the testimony of protestant's husband. No supporting documentation of these markup estimates was provided.

Product markup can be estimated in a variety of ways. Shelf tests can be performed and compared to invoices. Estimates derived from surveys conducted by national trade associations may be appropriate in some cases. Protestant and the Division may be able to agree on the appropriate markups to use in some cases. There is no single best way to determine markups. The specific facts and circumstances of each audit must be evaluated when determining the markups to be used.

The evidence in this matter establishes and protestant concedes that the protestant did not keep all of the records required by statute or by Tax Commission Rule. 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. Evidence furnished by a taxpayer which would reasonably indicate that the audit methodology may be inaccurate should be considered.

Because of the specific facts and circumstances of this case we remand this matter to the Office of the Administrative Law Judge with directions that the Division be instructed to revise the assessment using the protestant's records to estimate the purchases of the taxpayer and applying an appropriate markup to determine taxable sales. Protestant should be afforded the opportunity to respond to such revised assessment.

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."