JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2012-07-17-06 / NON-PRECEDENTIAL**
ID: **P-10-731-H**
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 17th day of February, 2012, the Commission denies the request of the Compliance Division for consideration en banc, and makes the following Findings of Fact and Conclusions of Law and enters the following order.

PROCEDURAL HISTORY

On August 9, 2010, the protest file was received by the Office of 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]

On August 16, 2010, OTC ATTORNEY 1 and OTC ATTORNEY 2, Assistant General Counsel, filed an Entry of Appearance as Co-Counsel for the Division. On August 18, 2010, a letter was mailed to CPA, CPA, stating this matter had been assigned to ALJ, Administrative Law Judge, and docketed as Case Number P-10-731-H. The letter also advised that a Notice of Prehearing Conference would be sent by mail and enclosed a copy of the *Rules of Practice and Procedure Before the Office of Administrative Law Judges.*[3]

On September 10, 2010, the Notice of Prehearing Conference was mailed to the last-known address of CPA, setting the prehearing conference for October 5, 2010, at 2:30 p.m.[4]

On October 5, 2010, the Division filed a Status Report In Lieu of Appearance at Pre-Hearing Conference advising that CPA needed until October 25, 2010, to submit documentation to the Division.

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[1] OKLA. STAT. ANN. tit. 68, § 201 et seq. (West 2001).

[2] OKLA. ADMIN. CODE §§ 710:1-5-20 through 710:1-5-47.

[3] *Id.*

[4] OKLA. STAT. ANN. tit. 68, § 208 (West Supp. 2012). The notice was mailed to CPA at CPA ADDRESS.

On November 12, 2010, a letter was mailed to the parties' Representatives directing that a status report be filed on or before November 24, 2010. On November 19, 2010, the Division filed the Status Report advising that CPA had provided boxes of documents for the Division's review. On November 23, 2010, a letter was mailed to the parties' Representatives stating a status report was due on or before January 24, 2011.

On January 21, 2011, the Division filed the Status Report advising that a meeting was set with CPA on February 8, 2011, to discuss the documents provided to the Division. On January 21, 2011, a letter was mailed advising that a status report was due on or before March 25, 2011.

On February 17, 2011, the Notice of Substitution of Attorney and Entry of Appearance was filed by OTC ATTORNEY 3 and OTC ATTORNEY 1, as Co-Counsel for the Division.[5]

On March 28, 2011, the Division filed the Status Report advising that the documentation provided by the Protestants was insufficient to revise the proposed sales tax assessments and requesting that this matter be set for hearing. On March 29, 2011, a letter was issued setting this matter for hearing on May 9, 2011, at 9:30 a.m., with position letters or memorandum briefs due on or before May 2, 2011.

On April 22, 2011, a Joint Motion to Strike and Reschedule was filed on the basis that CPA was scheduled to be out of town on April 28, 2011, and would not return until May 16, 2011. On April 27, 2011, an Amended Scheduling Order was issued striking the hearing from the May 9th docket and resetting the hearing for June 20, 2011, at 9:30 a.m., with position letters or memorandum briefs due on or before June 13, 2011.

On May 27, 2011, ATTORNEY 1 filed an Entry of Appearance as Counsel for the Protestants.

On June 9, 2011, ATTORNEY 1 filed a Motion for Continuance of Hearing Date as more fully set out therein. On June 15, 2011, an Amended Scheduling Order was issued striking the hearing from the June 20th docket and setting the hearing for August 2, 2011, at 9:30 a.m., with position letters or memorandum briefs due on or before July 26, 2011.

On July 27, 2011, the Division's Unopposed Motion for Continuance was filed advising the Division was revising the proposed sales tax assessments to correct the amount of reported beer purchases for 2009, which would increase the proposed assessments. On July 28, 2011, an Amended Scheduling Order was issued striking the hearing from the August 2nd docket and setting the hearing for September 20, 2011, at 9:30 a.m., with position letters or memorandum briefs due on or before September 13, 2011.

[5] This filing serves as a Withdrawal of Counsel for OTC ATTORNEY 2.

On August 3, 2011, the Division's Notice of Sales Tax Revision ("1st Revision") was filed with attachments thereto. On August 5, 2011, a letter was mailed advising the Protestants could file a response, limited to the issues addressed in the 1st Revision, on or before August 18, 2011. On August 18, 2011, the Protestants' Response and Protest of Notice of Revision was filed with attachments thereto.[6]

On September 13, 2011, an Entry of Appearance was filed by ATTORNEY 2 as Co-Counsel of record for the Protestants. On September 13, 2011, the Protestants' Position Statement and Brief in Support was filed, with Exhibits 1 through 29 attached thereto. On September 13, 2011, the Division's Brief was filed, with Exhibits A through M attached thereto. On September 19, 2011, the Protestants' Motion for Determination Regarding Record Entry for Hearing ("*Motion*") was filed with the Court Clerk.[7] On September 19, 2011, at 3:30 p.m., a teleconference was held with Counsel. After discussing the Protestants' *Motion*, Counsel was advised that a ruling on the *Motion* would be reserved until the hearing scheduled the next day. On September 20, 2011, at 9:30 a.m., a closed hearing[8] was held as scheduled. ATTORNEY 2 and ATTORNEY 1 appeared on behalf of the Protestants. OTC ATTORNEY 3 and OTC ATTORNEY 1 appeared on behalf of the Division. The ruling on the Protestants' *Motion* was reserved until the Protestants identified and offered the exhibits in question to be admitted into evidence. The Division, through OTC ATTORNEY 3, invoked the Sequestration Rule,[9] with witnesses being duly instructed by the Administrative Law Judge. ATTORNEY 2 made an opening statement. The Division waived its opening statement. The Protestants and the Division called PRESIDENT, President of COMPANY d/b/a STORE, who testified about business practices, records, and the audit. The Protestants' second witness, CPA, CPA/POA ("CPA"),[10] testified about his representation of the Protestants during the audit and the Protestants' records. The Protestants Exhibits 12-C through 12-M,[11] 15-C, 15-D,[12] 15-E,[13] and 26-E[14] were identified, offered, and admitted into evidence.[15] The Protestants and the Division called

[6] On August 18, 2011, a copy was also received by facsimile.

[7] OKLA. ADMIN. CODE § 710:1-5-10(c)(2) (June 25, 1999).

[8] The Protestants, through ATTORNEY 2, invoked their right to a confidential hearing as provided by the provisions of OKLA. STAT. ANN. tit. 68, § 205 (West Supp. 2012). Tr. at 5.

[9] OKLA. STAT. ANN. tit. 12, § 2615 (West 2009). Tr. at 10.

[10] ALJ's Exhibit 2, PROT.000006. Tr. at 41.

[11] These exhibits were admitted on the basis that they purported to be "summaries" of the Protestants' sales, not as to the veracity or accuracy of the Protestants' purported monthly sales. Tr. at 33-38.

[12] Tr. at 25-27.

[13] Tr. at 29 with qualification for the record.

[14] Tr. at 72-73.

[15] The Protestants' Exhibits 7-A, 26-D, and 24 were offered and identified, but were not admitted into evidence. Protestants' Exhibits 30-A through 30-M were withdrawn by ATTORNEY 2, but were offered again. The Division's objection was sustained, with exceptions noted for the record. Tr. at 89, and 98-105.

AUDITOR, Field Auditor ("Auditor"), Field Audit Section of the Compliance Division,[16] Oklahoma Tax Commission, who testified about the conduct of the audit, the audit methodology, and as custodian of the Division's records. The Protestants and the Division called SUPERVISOR, Revenue Unit Manager ("Audit Supervisor"),[17] Field Audit Section, Compliance Division, Oklahoma Tax Commission, who testified about the audit methodology, the source of the data used in the audit model, average percent markup versus margin, and the use of data from the National Association of Convenience Stores for audit purposes. The Division's Exhibits A through D[18] and G through N were identified, offered, and admitted into evidence without objection.[19] The Division's Exhibit E was identified, offered, and admitted into evidence with objections noted for the record. The Division's Exhibit F was identified, offered, and admitted into evidence with qualification.[20] During closing argument, the Division requested that a twenty-five percent (25%) negligence penalty and/or fifty percent (50%) fraud penalty be assessed against the Protestants.[21] ATTORNEY 2 made a closing statement on behalf of the Protestants. The Administrative Law Judge announced at hearing that he was taking judicial notice of the following, to-wit:

- OTC Order No. 2010-08-17-03 (August 17, 2010)[22]
- Copies of NACS Computation in Case No. P-09-188-H[23]
- Division's Work Papers in Support of Its Use of National Convenience Store Averages in Case No. P-09-188-H, with Exhibits attached thereto[24]
- Oklahoma Administrative Code § 710:20-2-5 (June 25, 1998)[25]
- The 2008 NACS State of the Industry Report admitted into evidence in Case No. P-10-233-K[26]

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[16] Auditor has been employed as an auditor by the Tax Commission for approximately twenty (20) years. Tr. at 61.

[17] Audit Supervisor has been employed in this position for approximately six (6) years and supervising "field" audits on Convenience Stores for approximately five (5) years. Tr. at 70.

[18] Tr. at 106-109. Exhibit B2 was admitted with exceptions noted for the record.

[19] The parties stipulated to the admission of Division's Exhibit N. Tr. at 124.

[20] Protestants' Counsel stipulated "…to the fact that [the exhibit] is a compilation by the OTC but not to the numbers." "Not to the accuracy or validity of the 3.2 BEER DISTRIBUTOR ONE beer and 3.2 BEER DISTRIBUTOR TWO distributed." Tr. at 110.

[21] Tr. at 143.

[22] Redacted copies were given to Counsel. Tr. at 146-150.

[23] *Id.*

[24] *Id.*

[25] Tr. at 142.

[26] This is an exhibit of the Protestant in P-10-233-K, who is represented by ATTORNEY 2 and ATTORNEY 1. Tr. at 147-148.

At the conclusion of the hearing, the record in this matter was held open for the following,[27] to-wit:

1. On or before **October 26, 2011**, the Division is to revise the proposed sales tax assessments to take out "Hot Food Service." Work Papers are to be attached to show how the revision was made by the Division.

2. On or before **October 26, 2011**, the Division is to supply the spreadsheet(s)/pie chart(s) from the 2008 "Summit," which reflects the Top Ten (10) categories, including each category's average percentage contribution to "Inside Sales" and "Inside Gross Margin Dollar Contribution." See Page 58 of 2008 NACS State of the Industry ("SOI") Annual Report. These exhibits will be identified and admitted into evidence as **ALJ's Exhibit 1**.

3. The Protestants are to provide the records which they seek to have admitted into evidence pursuant to its [*Motion*] filed September 19, 2011. The Protestants are to organize and place "Bates numbers" on each page and submit copies to the Division on or before **October 26, 2011.** The records will be identified as **ALJ's Exhibit 2**. The Division may file an objection to the Protestants' *Motion* as to any portion of ALJ's Exhibit 2 on or before **November 14, 2011**. If an objection is filed by the Division, the *Motion* will be submitted for ruling and an order will issue on the admissibility of all or part of the records identified as ALJ's Exhibit 2.

4. By **October 26, 2011**, the Division is to submit complete copies of the 3.2 beer reports received from the Protestants' distributors for the Audit Period on the convenience store located at STORE ADDRESS. These documents will be identified and admitted into evidence as **ALJ's Exhibit 3**.

5. By **October 26, 2011**, the Division is [to] file a post-hearing brief, with documents attached thereto, which explains the differences in the Top Ten (10) Categories and Percentages between the 2008 "Summit" and the 2008 NACS SOI Report, the Division's adjustments for "liquor" and "wine,"[28] which are not sold in the State of Oklahoma by convenience stores, and explains in detail how the 2008 model works, supported by documentation similar in nature to the redacted copies of the Division's filing in P-09-188-H, which supports the

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[27] On September 26, 2011 ("September 26th Letter"), a letter was mailed to Counsel memorializing the announcements made at the conclusion of the hearing.

[28] Although not specifically mentioned at hearing, the NACS Categories include Publications. Newspapers and periodicals are also not subject to sales tax in the State of Oklahoma. *See* 2008 NACS SOI [Annual] Report, Pages 59 and 62. *See also* OKLA. ADMIN. CODE § 710:65-13-190. (Footnote original.)

> conclusion in OTC Order No. 2010-08-17-03 (August 17, 2010) that the Division's indirect audit approach is supported by "substantial evidence." Copies of the Division's filing and order were provided to the parties at hearing. On or before **November 14, 2011**, the Protestants may file a response to the Division's post-hearing brief. The undersigned or the parties may request a supplemental hearing for the purpose of receiving testimony from the Division restricted to the matter(s) contained in its post-hearing brief. (Emphasis original.)

On September 28, 2011, the Division filed the Response to Administrative Law Judge's Request for Explanation of Division's Use of NACS to Compute Taxable Sales ("Response"), with Exhibits attached thereto, which is identified and admitted into evidence as ALJ's Exhibit 1. On September 28, 2011, the Division filed its Notice of Other State's Decision, with attachments thereto. On September 30, 2011, a letter was mailed to Counsel requesting the Division to provide the following,[29] to-wit:

> Based upon the Division's Response to Administrative Law Judge's Request for Explanation of Division's Use of NACS to Compute Taxable Sales ("Response"), the following additional information is requested to be filed on or before **October 26, 2011**:
>
> 1. A copy of the complete work papers and supporting documentation reflecting how the 3.2 beer percentage of 21.64% was calculated using the "the weighted average or rounding of beer margins from NACS data for previous years (2005 and 2006)."[30]
> 2. On Exhibit G to the Division's Response, the NACS margin in % for "foodservice" is broken down into subcategories. Please provide the complete work papers and supporting documentation which reflects how these percentages were calculated.
> 3. On Exhibit G to the Division's Response, the NACS margin in % for "other dept" is expressed as 0.3388. Please provide the complete work papers and supporting documentation which reflects how this percentage was calculated and what categories/subcategories from the 2008 NACS SOI Report comprise "other dept."

On October 5, 2011, the Division's Response to Administrative Law Judge's Request of September 30, 2011 ("Reply") was filed with attachments thereto. On October 10, 2011, in a letter based upon the Division's Reply, the following additional information was requested to be filed on or before October 26, 2011:

> 1. In its [Reply] the Division has already provided numerous pages from the *NACS SOI SUMMIT (April 6-8, 2009 • Chicago, Illinois);* therefore, on or

[29] *See* letter dated September 30, 2011.

[30] Response at 3. (Footnote original.)

> before **October 26, 2011**, the Division is directed to file a complete copy of the ["Summit"] with the Court Clerk, which reflects a copy has been provided to opposing Counsel**.** The ["*Summit*"] should have "Bates" numbers added to the pages and will be identified and admitted into evidence as **ALJ's Exhibit 4.** (Emphasis original.)

On October 11, 2011, the Division filed its Submission of ALJ's Exhibit 4.[31] On October 17, 2011, the Division's Notice of Sales Tax Revision ("2nd Revision") was filed with attachments thereto. On October 17, 2011, the Division filed its Submission of ALJ's Exhibit 3 with attachments thereto. On October 19, 2011, a letter was mailed requesting the Division to provide additional information based upon the 2nd Revision on or before October 26, 2011, as follows, to-wit:

> 1. Using the Worksheets attached as Exhibits C1 through C3, produce Worksheets using all NACS P-Mix (do not take out hot food). I want both scenarios available using the same model.

On October 20, 2011, the Division filed its Response to Administrative Law Judge's Request for Additional CSGS Worksheets Which Include All of the NACS Product Mixes with attachments thereto. On October 26, 2011, the Division filed its Request that Post-Hearing Submissions Be Accepted In Lieu of Compliance Division's Post-Hearing Brief ("Request"). On October 26, 2011, the Protestants filed ALJ's Exhibit 2, with "Bates" numbers PROT.000001 through PROT.002568 added thereto.[32]

On November 1, 2011, the Court Clerk received a letter from ATTORNEY 1 requesting a transcript of the hearing held in this matter on September 20, 2011, at approximately 9:30 a.m. On November 9, 2011, the Protestants' Response to OTC's Request That Post-Hearing Submissions Be Accepted in Lieu of Compliance Division's Post-Hearing Brief was filed. On November 10, 2011, the Court Clerk mailed a letter to Protestants' Counsel advising the transcript had been completed with $377.50 due. On November 14, 2011, the Protestants' Submission of Curriculum Vitae for EXPERT as Statistician Expert Witness was filed with attachment thereto. On November 14, 2011, the Court Clerk received payment in full from LAW FIRM for the transcript. The Court Clerk distributed copies of the transcript to Counsel. On November 14, 2011, the Compliance Division's Objection to Protestants' Offer of Admission into Evidence Documents Included in ALJ Exhibit 2 was filed. On November 14, 2011, at 10:00 a.m. a teleconference was held with Counsel at the request of the Administrative Law Judge to discuss due dates, rulings, etc. On November 16, 2011, the Division's Previous Submission of 2008 NACS Summit was filed.[33] On November 16, 2011, the Compliance

[31] This is the Division's copy of the "Summit" with "Bates" numbers added by the Division (NACS000001 through NACS000070).

[32] The Protestants also provided a CD containing the documents comprising ALJ's Exhibit 2 in an electronic format. *See* ALJ's Exhibit 2. The CD is marked as Sub-Divider 12, which was added by the Court Clerk for organization purposes only.

[33] The Division asserted that a copy of the "Summit" had been previously admitted into evidence in another proceeding, but the Division was mistaken, as stated in its filing.

Division's Objection to Protestants' Request to Extend Due Date for Filing Post Hearing Response Brief for Ninety Days was filed as more fully set forth therein. On November 18, 2011, the Order Sustaining in Part and Overruling in Part Division's Objection to Protestants' Motion for Determination Regarding Record Entry for Hearing was issued as more fully set forth therein. On November 18, 2011, the Order Granting Request That Post-Hearing Submissions Be Accepted In Lieu of Compliance Division's Post-Hearing Brief and Sustaining In Part and Denying in Part Protestants' Response was issued as follows,[34] to-wit:

- The [Protestants] are barred from raising the new issue, as set forth herein, in its post-hearing brief, and specifically from using any information obtained from EXPERT in its post-hearing brief or subsequent hearing in this matter, if any.
- The Protestants' request to extend the due date for its post-hearing brief to January 14, 2012, is denied.
- The Protestants' post-hearing brief is due on or before November 30, 2011.
- The Division may not file a response to the Protestants' post-hearing brief. A response was not provided for in the letter of September 26th.

On November 30, 2011, the Protestants' Post-Hearing Brief was filed, with Exhibits 1 through 26 attached thereto.

On December 6, 2011, the Order: Striking Exhibits from Protestants' Post-Hearing Brief,[35] Denying Protestants' Motion to Strike Division's Notice of Other State's Decision, and Closing Record and Submitting Case for Decision was issued as more fully set forth therein. In particular, Protestants' *Motion to Strike* was denied and, after a review of the post-hearing filings, exhibits, etc. and the Protestants' Post-Hearing Brief, the record in this matter was to be closed and the case submitted for decision on December 12, 2011. However, the record was held open another seven (7) days to see if either party would file a motion for a supplemental hearing. No further filings were received from Counsel.[36] The record in this matter was closed and this case submitted for decision on December 19, 2011.

On February 17, 2012 the Administrative Law Judge issued his Findings, Conclusions and Recommendations in this matter. On March 15, 2012 the Division filed a Motion for Reconsideration and Rehearing. On March 30, 2012 the Protestants filed a Response to Motion for Reconsideration and Rehearing. On April 3, 2012 the Administrative Law Judge issued an

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[34] In the Protestants' Post-Hearing Brief the issue of business records being excluded by the ALJ was raised, along with materials from the Protestants' "Statistical Expert." These issues are addressed in the November 18th order and the December 6, 2011, order. The vast majority of the records excluded were duplicates. The Division's objection to the materials from the Protestants' "Statistical Expert" was sustained on the basis of "issue exclusion." The Protestants first raised the issue to be addressed by their "expert" after the September 20th hearing.

[35] The order striking exhibits from the Protestants' Post-Hearing Brief was upon the motion of the Administrative Law Judge, based upon the November 18th order.

[36] *See* September 26th Letter filed herein.

Order Denying Division's Motion for Reconsideration and Rehearing. On May 16, 2012 the Division filed an Application for En Banc Hearing. On May 31, 2012 the Protestants filed their Response to Division's Application for En Banc Hearing.

FINDINGS OF FACT

I. PRE-AUDIT THROUGH ORIGINAL ASSESSMENTS

Upon review of the file and records, including the record of the proceedings, the exhibits received into evidence, the briefs, the transcript, and post-hearing filings, the undersigned finds:

1. On April 11, 2000, PRESIDENT, as President ("President") and sole officer of COMPANY d/b/a STORE ("STORE")[37] filed a Business Registration Application for STORE to operate a convenience store/gas station located at STORE ADDRESS.[38] STORE sells a variety of items, including but not exclusive of gasoline, tobacco, cigarettes, 3.2 beer, candy, grocery items, and lottery tickets, but STORE does not sell "hot food."[39]

2. On October 1, 2009, an Audit Lead Sheet was approved by the Division on STORE. The Audit Lead Sheet states, "TP is selling unstamped cigarettes. TP is paying employees cash and not withholding income tax. TP is abusing Food Stamp Program. TP is not reporting accurate gross sales."[40]

3. On December 7, 2009, the Division mailed a letter to STORE notifying that it had been selected for an audit.[41]

4. On December 11, 2009, the Auditor called and left a message for President.[42]

5. On December 18, 2009, President returned the call and advised Auditor to work with CPA.[43]

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[37] The President is the sole officer of STORE. Tr. at 13. *See* Division's Exhibits D1 and H.

[38] Division's Exhibit A.

[39] Tr. at 13.

[40] Division's Exhibit B. Attached to the exhibit is a copy of an anonymous letter dated March 26, 2008, from a "Concerned Oklahoma Resident," which is the source of the allegations set forth in the Audit Lead Sheet. Handwritten on the Audit Lead Sheet is "2007 Purchases Beer – 183884.93, 2007 Sales Reported – 152799.00, Unreported - $31085.93." According to the Field Audit Write Up the Auditor did not conduct a withholding audit because President would not provide records, there is no indication whether STORE was selling unstamped cigarettes because the Auditor never went to STORE and checked. There is also no mention of food stamps in the Field Audit Write Up. *See* ALJ's Exhibit 2, PROT.0000004-PROT.0000005.

[41] Division's Exhibit C.

[42] ALJ's Exhibit 2, PROT.000016.

[43] *Id.*

6. On January 12, 2010, the Auditor received a copy of the Power of Attorney to represent STORE in the audit.[44]

7. On March 2, 2010,[45] the Opening Conference was held at the office of CPA. The President of STORE was present at the meeting. Auditor presented a standard "Records Request,"[46] along with Taxpayer's List of Principal Officers form,[47] an Established Mark-up Percentages form, a Suppliers Contact Approval form, and a Statute of Limitations Waiver form to be completed and returned to the Division.[48]

8. The President completed and returned the List of Principal Officers form, the form To Establish Markup Percentages for use in Sales Tax Audit,[49] and the form for Suppliers Contact Approval.[50] The Statute of Limitations form was not signed and returned to the Division.[51]

9. On March 10, 2010,[52] Auditor returned to CPA's offices to review STORE's records. Several boxes of monthly envelopes containing purchase invoices, bank statements, and "possibly" general ledgers were provided, but many of the records were "…wet and moldy, and they kind of, you know, didn't smell so great, so I didn't spend a lot of time with those."[53] Since STORE did not provide sales summaries or Z-Tapes, Auditor knew the Division would default to the National Association of Convenience Stores Gross Sales Computation ("NACS Computation") based upon the "Summit."[54]

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[44] *Id.* *See* ALJ's Exhibit 2, PROT.000006. Tr. at 41.

[45] ALJ's Exhibit 2, PROT.0000003-PROT.0000004.

[46] ALJ's Exhibit 2, PROT.0000003-PROT.0000005 and PROT.000018-PROT.000019.

[47] Division's Exhibit D1.

[48] Tr. at 41-42.

[49] Division's Exhibit D2. On the form, STORE indicated its "Markup Percentages" as 23% (Soda, Bottles and Cans), 30% (Soda, Fountain), 31% (Cigarettes and Tobacco), 12% (Beer), 22% (Candy), 17% (Chips), 12% (Dairy), 24% (Grocery), 25% (Health and Beauty Aids), and 20% (Energy Drinks). STORE also indicated that it had a "…comprehensive price list which includes all products sold," and would "…provide it to the auditor along with copies of the purchase invoices on which wholesale prices per unit are clearly indicated."

[50] Division's Exhibit D3. Ten (10) vendors are listed on the form.

[51] ALJ's Exhibit 2, PROT.0000003.

[52] *See* Status Report filed November 19, 2010. The Auditor was to prepare a schedule of the Protestants' documents. *See also* Division's Exhibit N.

[53] Tr. at 64.

[54] *Id.* *See* ALJ's Exhibit 4.

10. Auditor did not visit STORE during the "field" audit due to "travel restrictions."[55] The Division did not perform a shelf test at STORE to verify the Markup Percentages to be used in the audit because STORE failed to provide a comprehensive price list.[56] The "field" audit also did not address the audit lead as to whether STORE was selling unstamped cigarettes, paying employees in cash and not withholding income tax, or abusing the Food Stamp Program.[57]

11. STORE filed all sales tax reports from April 1, 2007, through December 31, 2009 ("Audit Period"),[58] reporting Net Taxable Sales, as follows:

TABLE A

Month	Year	Net Sales	Year	Net Sales	Year	Net Sales
			2008	11,210.00	2009	12,431.00
			2008	12,110.00	2009	11,231.00
			2008	14,431.00	2009	13,413.00
April	2007	13,410.00	2008	14,090.00	2009	8,312.00
May	2007	13,225.00	2008	13,481.00	2009	12,012.00
June	2007	13,310.00	2008	14,430.00	2009	11,917.00
July	2007	11,337.00	2008	14,408.00	2009	9,782.00
August	2007	13,411.00	2008	13,890.00	2009	9,331.00
September	2007	11,231.00	2008	12,531.00	2009	10,818.00
October	2007	13,110.00	2008	12,431.00	2009	9,342.00
November	2007	12,410.00	2008	12,421.00	2009	12,313.00
December	2007	13,450.00	2008	11,670.00	2009	16,431.00
Totals	2007	114,894.00	2008	157,103.00	2009	137,333.00

12. The Division compared 3.2 beer purchases from STORE's Distributors, 3.2 BEER DISTRIBUTOR ONE ("3.2 BEER DISTRIBUTOR ONE"), 3.2 BEER DISTRIBUTOR TWO ("3.2 BEER DISTRIBUTOR TWO"), and 3.2 BEER DISTRIBUTOR THREE to STORE's reported Net Taxable Sales for the Audit Period,[59] as follows, to-wit:

[55] ALJ's Exhibit 2, PROT.0000003. Tr. at 63 and 90-91. *See* Status Report filed November 19, 2010. If a Convenience Store is still open for business at the beginning of the "field" audit, the Division should consider requiring field auditors to visit the store and conduct a shelf test to establish the items being sold, such as "Hot Food," "Prepaid Phone Cards," "Lottery Tickets," etc. and the prices for each item, along with the approximate square footage of the Convenience Store, if square footage is a factor in the Division's Audit Model.

[56] *Id.*

[57] *See Findings of Fact 2* and ALJ's Exhibit 2, PROT.0000002-PROT.0000005.

[58] Division's Exhibit E.

[59] Division's Exhibit F.

TABLE B

Wholesaler	2007	2008	2009
3.2 BEER DISTRIBUTOR ONE	129,125.21	134,110.47	116,170.11[60]
3.2 BEER DISTRIBUTOR TWO	48,687.81	51,753.00	1,694.00
3.2 BEER DISTRIBUTOR THREE	6,072.00	0.00	0.00
Subtotals	183,885.02	185,863.47	117,864.11
Minus January through March 2007 (25%)	45,971.26		
Totals	137,913.77	185,863.47	117,864.11
Net Taxable Sales	114,894.00	157,103.00	137,333.00
Difference	23,019.77	28,760.47	(19,468.89)

13. The Division compared the Gross Sales Reported by STORE during the Audit Period to Gross Sales Reported on STORE's Federal Returns (Forms 1120S),[61] which are summarized as follows, to-wit:

TABLE C

Year	2007	2008	2009
Gross Sales Reported	1,311,153.00	1,843,900.00	1,544,371.00
Form 1120S	1,311,154.00	1,844,074.00	1,467,083.00
Difference	(1.00)	(174.00)	77,288.00

14. The Division used the NACS Computation ("Summit"), which is also referenced by the Division as the "CSGS Calculation," to determine STORE's Underreported Taxable Sales based upon STORE's 3.2 beer purchases from Distributors,[62] as follows, to-wit:

[60] There is a mathematical error in the original calculation. The amount should be $116,470.11 instead of $116,170.11. *See* Division's Exhibit M15.

[61] Division's Exhibit G.

[62] The Administrative Law Judge is taking judicial notice of the testimony and exhibits in Case No. P-09-188-H to complete the factual details and background of this audit. OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999). The Division has been using the NACS Computation based upon the "Summit" for approximately three (3) to four (4) years. This computation, or some variation thereof, is also used by the State of Texas, the State of California, and the Internal Revenue Service. The State of Texas conducted a state-wide survey of convenience stores, which are the percentages used by the State of Texas. The State of Oklahoma does not have a survey of convenience stores so the Division defaults to National Averages, much like the Division defaults to area-wide averages for mixed beverage depletion purposes when records are not available. *See also* OTC Order No. 2010-08-17-03 (August 17, 2010) entered in Case No. P-09-188-H. Judicial notice was announced to Counsel at hearing.

TABLE D

CONVENIENCE STORE
GROSS SALES COMPUTATION
[“SUMMIT”]
This chart is for use with Inside C-Store Sales

***This Worksheet was compiled using the National Association of Convenience Stores 2008 Annual Report of National Averages**

Average-Sized Store

ENTER JUST THE TOTAL BEER PURCHASES

ESTIMATED TOTAL SALES	$2,300,565.48

PERIOD: APRIL 1, 2007 THROUGH DECEMBER 31, 2007

DOLLARS OF PURCHASES BY DEPARTMENT*	PRODUCT MIX	DEPARTMENTS	AVERAGE PERCENT OF MARKUP[63]	GROSS DOLLARS OF SALES**
	32.70%	CIGARETTES	23.38%	$ 752,284.91
	13.90%	FOODSERVICE	55.00%	$ 319,778.60
	14.10%	PACKAGED BEVERAGES	37.66%	$ 324,379.73
$183,885.02[64]	**10.20%**	**BEER**	**21.64%**	**$ 234,657.68**
	1.40%	GENERAL MERCHANDISE	52.55%	$ 32,207.92
	3.20%	CANDY	47.98%	$ 73,618.10
	3.50%	SALTY SNACKS	38.38%	$ 80,519.79
	3.90%	OTHER TOBACCO	31.65%	$ 89,722.05
	3.10%	FLUID MILK PRODUCTS	35.08%	$ 71,317.53
	2.60%	PACKAGED SWEET SNACKS	26.85%	$ 59,814.70
	11.40%	OTHER DEPARTMENTS	47.42%	$ 262,264.46
	100.00%	TOTALS		$2,300,565.48
		Remove Cigarettes and Other Tobacco		(842,006.97)
		Sales Taxable Amount		1,458,558.51
		Reported Taxable Sales		(114,894.00)
		Unreported Sales		$1,343,664.51

*Dollars of Purchases in other categories are calculated from the base of Beer Purchases using the product mix shown.
**Gross Dollars of sales are calculated using margin percentage.

These averages are based on National Association of Convenience Stores (NACS) State of the Industry Report as of December 2008 in conjunction with CSX and Nielson Studies

Based on studies of 156 retail firms with 20,553 stores across the USA

Total Sales Contributions – Fuel 74.5% - Merchandise 21.3% - Foodservice 4.2%

[63] *See Findings of Fact 51-52 and the footnotes thereto.*

[64] *See* Division’s Exhibit F. *See also* Division’s Exhibits I1 through I3. This is one (1) of three (3) worksheets (I1). This worksheet is being “reproduced” (as closely as possible) for illustration purposes and to compare and contrast the worksheet with other worksheets “reproduced” hereinafter.

15. The results of the "field" audit using the NACS Computation based upon the "Summit" reflected STORE had Unreported Taxable Sales during the Audit Period,[65] as follows, to-wit:

TABLE E

April 1, 2007 through December 31, 2007	$1,343,664.51
2008 Tax Year	1,317,148.39
2009 Tax Year	797,553.93
Total Underreported Sales	$3,458,366.83

16. On March 26, 2010, the Closing Conference was held with the CPA and the President. The Auditor provided copies of the NACS Computation worksheets, supplemental information, and work papers to the CPA and the President.[66]

17. On April 30, 2010, the Division issued proposed sales tax assessments for the Audit Period against the Protestants,[67] as follows, to-wit:

TABLE F

Tax Due:	$278,663.23
Interest @ 15% through 06/30/2010:	66,535.49
Tax & Interest due within 30 Days:	345,198.72
30 day delinquent Penalty @ 10%:	27,866.33
Tax, Interest & Penalty due after 30 Days:	$373,065.05

18. On June 23, 2010, the Division received a timely filed protest[68] to the proposed sales tax assessments against the Protestants for the Audit Period. The grounds for the protest are stated in pertinent part, as follows, to-wit:

> The audit was terminated when the auditor, [Auditor], learned that Z-Tapes were not available for the audit period. [Auditor] made no effort to use the books and record[s] available to verify the sales tax reports. These books and records included purchase invoices, monthly sales reports, bank statements, financial statements and tax returns. Instead, [Auditor] used industry averages to compute sales and to assess additional sales tax liability.

[65] *Id. See also* Division's Exhibit J2.

[66] ALJ's Exhibit 2, PROT.0000005.

[67] Division's Exhibits J and K. *See* ALJ's Exhibit 2, PROT.000027-PROT.000028.

[68] Division's Exhibit L. Tr. at 42-43 and 64-65.

II. FIRST REVISION THROUGH TELECONFERENCE OF SEPTEMBER 19, 2011

19. On July 26, 2011, the Division revised the proposed sales tax assessments ("1st Revision") against the Protestants for the Audit Period,[69] summarized as follows, to-wit:

TABLE G

Wholesaler	2007	2008	2009
3.2 BEER DISTRIBUTOR ONE[70] (75%)	96,843.91	134,110.47	116,470.11[71]
3.2 BEER DISTRIBUTOR TWO[72]	37,547.63	51,753.00	40,741.00
Totals	134,391.54	185,863.47	157,211.11
Total Underreported Sales	951,086.93	1,317,148.39	1,107,271.02 = 3,375,506.34[73]

Tax Due:	$272,808.69
Interest @ 15% through 08/30/2011:	104,473.57
30 day delinquent Penalty @ 10%:	27,280.87
Tax, Interest & Penalty due after 30 Days:	$404,563.13

20. On August 18, 2011, the Protestants filed the Response and Protest of Notice of Revision,[74] which states in pertinent part, as follows, to-wit:

> Taxpayer[s] protests and disagrees with the Proposed Assessment due to inaccuracies in the Division's calculation of Protestants' beer purchases and the inappropriate use of the default method when Protestants have substantially all sales, z-tapes, purchase, and bank records for the audit period

[69] Division's Exhibit M. "A correction was made to the 2009 information from the wholesalers (printouts attached). REPRESENTATIVE, representative at 3.2 BEER DISTRIBUTOR THREE, has confirmed that *3.2 BEER DISTRIBUTOR THREE only sells energy drinks in the CITY area* (telephone conversation 7/25/11), so the 2007 3.2 BEER DISTRIBUTOR THREE purchases were removed…" ("Emphasis added.) Division's Exhibit M1.

[70] 3.2 BEER DISTRIBUTOR ONE's records reflect the "Customer ID," "DBA Name," "Street Address," "City," "Zip Code," "Cases," and "Pkg Dollars." *See* Division's Exhibit M1 through M15.

[71] There is a mathematical error in the original calculation. The amount should be $116,470.11 instead of $116,170.11. *See* Division's Exhibit M15.

[72] *Id.* 3.2 BEER DISTRIBUTOR TWO's records reflect essentially the same information, but the purchases are broken down by "Month," "Cases," and "$Vol."

[73] *Id.*

[74] *See* Protestants' Response and Protest of Notice of Revision filed herein. Attached is a copy of STORE's 3.2 beer purchases the Protestants obtained from 3.2 BEER DISTRIBUTOR TWO for the Audit Period, along with the purchases of two (2) other convenience stores, which are the subject of another case. *See also* ALJ's Exhibit 2, PROT.001027-PROT.001028

> for all locations. *The Division's alleged beer purchases included non-alcohol and energy drink products which are not 3.2 beer and should not be attributed as such.* (Emphasis added.)

21. On or about October 25, 2010, CPA furnished boxes of documents to the Auditor for review.[75]

22. On February 8, 2011, the Division met with the CPA. The "Purpose of the meeting [was] to discuss the shortcomings of the Protestants' documents which were provided to the [A]uditor since the last status report and to provide guidance to Protestant as to what documentation [would] be acceptable to warrant any type of adjustment to the assessment."[76]

23. On March 28, 2011, the Division filed the Status Report,[77] which states in pertinent part, "The [A]uditor has reviewed the documentation provided by Protestants. The documents are inadequate to make any adjustments downward in the assessment."

24. On June 9, 2011, ATTORNEY 1 filed a Motion for Continuance of Hearing Date. The grounds for the motion are stated in pertinent part,[78] as follows, to-wit:

...

> c. Protestants require additional time to work with counsel to prepare for properly prepare [sic] [CPA's] records for hearing. Protestants' five (5) boxes of audit records are presently still within the Division's control and is scheduled to be picked up by Protestants' [CPA], on this 9th day of June, 2011.

25. On July 21, 2011, the Protestants obtained copies of STORE's 3.2 beer purchases from 3.2 BEER DISTRIBUTOR TWO, for the Audit Period, including, in pertinent part, April 2007 through December 2007, which reflect the following,[79] to-wit:

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[75] *See* Status Report filed November 19, 2010. The Auditor was to prepare a schedule of the Protestants' documents. *See also* Division's Exhibit N.

[76] *See* Status Report filed January 21, 2011.

[77] *See* Status Report filed March 28, 2011.

[78] *See* Motion for Continuance of Hearing Date filed herein. On September 12, 2011, the Division signed a receipt when the boxes of documents were picked up. *See also* ALJ's Exhibit 2, PROT.000972.

[79] *Id.* *See* ALJ's Exhibit 2, PROT.001027. The reason for detailing STORE's 3.2 beer purchases from 3.2 BEER DISTRIBUTOR TWO during April through December 2007 will be addressed hereinafter.

TABLE H

Month/2007	3.2 % Cases	Non Alc Cases	Rockstar Cases	Total Cases	3.2% Dollars	Non Alc Dollars	Rockstar Dollars	Total Dollars
April	255	0	4	259	3,297.00	0.00	114.00	3,411.00
May	352	0	0	352	4,823.00	0.00	0.00	4,823.00
June	415	0	0	415	5,350.00	0.00	0.00	5,350.00
July	260	0	1	261	3,325.00	0.00	29.00	3,354.00
August	369	(2)	(2)	365	4,798.00	(29.00)	(57.00)	4,712.00
September	263	0	0	263	3,283.00	0.00	0.00	3,283.00
October	280	0	0	280	3,577.00	0.00	0.00	3,577.00
November	353	0	(4)	349	4,559.00	0.00	(110.00)	4,449.00
December	347	0	0	347	4,588.00	0.00	0.00	4,588.00
					37,600.00	(29.00)	(24.00)	37,547.00

26. On September 19, 2011, the Protestants filed a Motion for Determination Regarding Record Entry for Hearing ("*Motion*").[80]

27. On September 19, 2011, at the request of the undersigned, a teleconference was held with Counsel regarding the filing of the Protestants' *Motion*.[81]

III. HEARING OF SEPTEMBER 20, 2011

SECTION A

SELECTED TESTIMONY AND EXHIBITS

28. CPA testified that Auditor agreed to a "sampling" consisting of four (4) months (February 2009, March 2009, April 2009, and May 2009) of Z-Tapes.[82]

29. Auditor testified that the Z-Tapes were requested to possibly adjust the Product Mix, "And that would only be if the beer sales were broken out."[83]

30. Protestants provided a "sampling" (July 2009 through October 2009) of purchase invoices from the following vendors,[84] to-wit:

[80] *See* Procedural History herein.

[81] *Id.*

[82] Tr. at 42-47. *See* Protestants Exhibits 12-C through 12-M.

[83] Tr. at 32-38 and 124-125. *See* Protestants' Exhibit 15-D. *See also* ALJ's Exhibit 2, PROT.001224-PROT.002470.

[84] Protestants' Exhibit 15-C. Vendors are paid by check or cash. Tr. at 31. The Protestants also provided invoices for the Audit Period. *See* ALJ's Exhibit 2, PROT.001224-PROT.002470.

TABLE I

- 3.2 BEER DISTRIBUTOR ONE
- 3.2 BEER DISTRIBUTOR TWO
- 3.2 BEER DISTRIBUTOR THREE
- VENDOR ONE
- VENDOR TWO
- VENDOR THREE
- VENDOR FOUR
- VENDOR FIVE
- VENDOR SIX
- VENDOR SEVEN
- VENDOR EIGHT
- VENDOR NINE

31. Of the invoices provided, 3.2 BEER DISTRIBUTOR ONE appears to be the only vendor which reflects a "Suggest Retail Price" for its products.[85]

32. Protestants provided a "sampling" of STORE's Bank Statements for the following accounts,[86] to-wit:

TABLE J

- BANK A (STORE's primary account). The Bank Statements are incomplete. Most are missing multiple pages. *None of the Bank Statements reflect that STORE makes any exempt "Food Stamp" sales.*
- BANK A (Line of Credit).
- BANK A (Lottery Account). Of the Bank Statements provided, these are the most complete.
- BANK B (Loan Account).

33. During the Audit Period, STORE filed its Sales Tax Reports through SERVICE COMPANY ("SERVICE COMPANY"), OWNER.[87] The President did not provide invoices, Z-Tapes or "actual" Z-Tape summaries to SERVICE COMPANY. The President "prepared" Monthly Z-Tape Summaries for SERVICE COMPANY to use in filing STORE's Monthly Sales Tax Reports.[88]

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[85] *Id.*

[86] Protestants' Exhibit 15-E. The periods covered by the Bank Statements range from outside the Audit Period to sporadic months throughout the Audit Period. As stated above, the only statements which are close to being complete are from the "lottery" account.

[87] The President testified that he thought the name of the service was "INCORRECT NAME," but the receipts in the record reflect that the President's recollection was incorrect. ALJ's Exhibit 2, PROT.002422 and Tr. at 50.

[88] Tr. at 32-33.

34. CPA could not determine STORE's percentage of 3.2 beer sales for the Audit Period because on "…a good portion of the Z tapes, beer was rung into groceries."[89]

35. CPA did not perform a "Shelf Test" at STORE or use a STORE "Price List" to determine STORE's markup on products. CPA used the "Suggested Selling Price" on the invoices.[90]

36. CPA could not determine STORE's Product Mix from a review of the Z-Tapes; "…looking at the Z tapes, that it was not possible for me to determine a product mix because of the way the products were rung up."[91]

37. Auditor visited STORE for the first time a couple of weeks before the hearing to verify that STORE did not sell "Hot Food." Auditor verified that STORE did not sell "Hot Food." The Division was to make an adjustment post-hearing.[92]

38. The Auditor testified: *"The schedules and the subsequent data on the CD did seem to match the Z tapes. I didn't check ever one. I checked quite a few of them."*[93] (Emphasis added.)

39. The Division did not use the "Sampling Method" to audit STORE because the 3.2 beer was not rung up separately, but "…lumped into another category for the most part."[94]

40. Despite travel restrictions, when a Taxpayer has provided the Division a product mix, Audit Supervisor will authorize an auditor to make a trip to the location and verify what is at the convenience store.[95]

41. After reviewing the boxes of documents provided by the Protestants, the Auditor prepared a schedule for 2009[96] "Compar[ing] Income Statements with Purchase Invoices with Z-Tape Sales,"[97] which is summarized as follows, to-wit:

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[89] Tr. at 49.

[90] Tr. at 53-54. As was noted earlier, the only invoices in the record that appear to reflect a "Suggested Retail Price" are the invoices from 3.2 BEER DISTRIBUTOR ONE. *See*, for example, ALJ's Exhibit 2, PROT.002263. *See also* Tr. at 124. Auditor testified that she had not been provided a STORE Price List.

[91] Tr. at 54. *See also* Tr. at 124-125. Auditor testified that she had requested a sample of Z-Tapes to "…possibly…adjust the product mix. And that would only be if the beer sales were broken out. Then maybe I could tell what amount of taxable sales were represented by beer sales. But they appeared to mostly have been lumped in all one category, which was just grocery, I believe."

[92] Tr. at 63-64. *See* Compliance Division's Notice of Sales Tax Revision filed October 17, 2011, which takes out "Hot Food."

[93] Tr. at 66.

[94] Tr. at 67.

[95] Tr. at 90-91.

TABLE K

Income Statements	Non Taxable Sales	Taxable Sales	Gasoline Sales	Other Income	Rebates	Total
Revenues	288,087.25	86,863.88	658,787.84	7,219.97	3,344.80	1,044,303.74
Cost of Sales	**Purchases**		**Gas Purchases**	**Cigarette Buydowns**		**Total**
	443,811.21		524,874.64	omitted		968,685.85

Taxable Sales Per Auditor	Taxable Sales per Z-Tapes[98]	Underreported Taxable Sales
314,303.42	302,325.88	11,977.54

Sales Tax Per Auditor	Tax Collected Per Z-Tapes	Uncollected Sales Tax
26,322.91	23,219.64	3,103.27

42. The Auditor testified that "…you would expect to see, as a rule of thumb, 35 percent overall markup on inside sales. So you would expect those numbers to be about 1.3 to 1.4. Well, you'll see that they range from 1.18 all the way down to .53. That tells me that we are probably missing some invoices."[99] Auditor also testified that the thirty-five percent (35%) figure is not based upon any set of audit rules or publication, "It's not a hard and fast rule, no."[100] Auditor compared Non Taxable Sales (Income Statements) to Purchases (Invoices)[101] as follows, to-wit:

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[96] Tr. at 116-130. After examining the documents, the Auditor thought that 2009 was the only year in tact enough to examine to see whether the records were all present and could be relied on. Income Statements were missing for March, April, November, and December 2009.

[97] Division's Exhibit N, which consists of twenty-five (25) pages. *See* select portions of ALJ's Exhibit 2, which were admitted into evidence. *See also* Order Sustaining in Part and Overruling in Part Division's Objection to Protestants' Motion for Determination Regarding Record Entry for Hearing, which was issued November 18, 2011, for the specific portions of ALJ's Exhibit 2, which were admitted into evidence. The order contains forty-five (45) separate evidentiary rulings.

[98] *Id.* Auditor notes that thirty percent (30%) of the Z-Tapes are missing for 2008. For 2009, Auditor notes that three (3) Z-Tapes were missing from January, two (2) from February, three (3) from March, two (2) from April, three (3) from May, three (3) from June, two (2) from July, one (1) from August, two (2) from September, one (1) from October, fifteen (15) from November, and three (3) from December. For 2007, only five (5) days of Z-Tapes were provided for November 2007. *See* ALJ's Exhibit 2, PROT.000128. Z-Tapes are numbered sequentially. For example, January 2009's Z-Tapes are numbered 541-571. Three (3) days of Z-Tapes are missing, 549 for the 9th, 554 for the 14th, and 559 for the 19th.

[99] *Id.* *See* Tr. at 118-119. *See also* Tr. at 127.

[100] Tr. at 127.

[101] *Id.*

TABLE L

Income Statements	January	February	March	April	May	June	July	August	September	October	November	December	Total
Taxable Sales	12,431.04	11,231.10			12,011.53	11,917.33	9,781.54	9,331.09	10,818.35	9,341.90			86,863.88
Gross Sales	125,286.51	118,215.66			128,006.68	124,262.75	146,725.78	136,248.18	139,601.94	125,956.24			1,044,303.74
Purchases	10,557.04	15,327.27	16,549.05	14,438.75	19,177.84	22,410.28	16,802.66	15,668.57	16,933.25	13,376.15	19,785.82	12,322.04	193,348.72
Overall Markup	1.18	0.73			0.63	0.53	0.58	0.60	0.64	0.70			
Auditor's Calculation of Taxable Sales per Z-Tapes	26,127.39	24,986.24	27,438.14	27,554.42	29,667.77	28,975.79	29,441.33	30,955.69	25,795.68	25,403.76	0.00[102]	25,979.67	302,325.88
Auditor's Calculation of Overall Markup	2.47	1.63	1.66	1.91	1.55	1.29	1.75	1.98	1.52	1.90		2.11	

43. From examining STORE's Z-Tapes, the Auditor testified as follows,[103] to-wit:

> Q Okay. You stated that the Z tapes were showing more sales than were reported on the sales tax reports.
> A That is correct.
> Q Do you have any reason to believe that the Z tapes were inaccurate?
> A No.
> Q So would it be safe to say that possibly you could have calculated an assessment based off of the Z tapes?
> A I would say there are numerous ways I could calculate an assessment, yes.
> Q And you're not claiming that the taxpayer rang up items as non-taxable that were actually taxable; you're just saying that they weren't itemized correctly?
> A I can't say either way.

44. During the course of the "field" audit, the Protestants did not provide a beginning or ending inventory for the Audit Period.[104]

45. President could not offer an explanation as to why STORE underreported sales during the Audit Period based upon a comparison of STORE's Z-Tapes and Reported Sales/Tax. President did admit that STORE had underreported sales for most of the Audit Period. A comparison of STORE's Z-Tapes[105] and STORE's Sales Tax Reports/Remittances reflect the following,[106] to-wit:

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[102] November 2009 was the month missing fifteen (15) days of Z-Tapes. *See* Division's Exhibit N.

[103] Tr. at 127-128.

[104] Tr. at 130-131.

[105] Only November 2007 Z-Tapes are available and only five (5) days are provided. Some Z-Tapes are available for the 2008 Tax Year, but some months have the wrong Z-Tapes attached to the summary, while others

TABLE M

Z-Tapes 2009	Tax Collected	Reported 2009	Tax Remitted	Underreported/ Over-Reported	Percentage Underreported/ Over-Reported
January	1,888.97	January	982.05	906.92	48%
February	1,780.88	February	887.25	893.63	50%
March	2,132.11	March	1,059.63	1,072.48	50%
April	2,089.22	April	677.17	1,412.05	67%
May	2,216.84	May	978.60	1,238.24	55%
June	2,237.53	June	970.86	1,266.67	56%
July	2,170.26	July	796.93	1,373.33	63%
August	Not in Exhibit	August	760.19	NA	NA
September	59.07	September	881.33[107]	NA	NA
October	1,916.15	October	761.09[108]	1,155.06	60%
November	839.74	November	1,003.12[109]	(163.38)	(19%)
December	1,728.60	December	1,338.62[110]	389.98	22%

According to the Protestants' Z-Tapes, STORE underreported and under-remitted Sales Tax for at least nine (9) of the twelve (12) months for 2009 (August 2009 was not in ALJ's Exhibit 2). Note that this underreporting does not take into account the Auditor's examination of the Protestants' records as set out hereinabove in Findings of Fact 41, which indicates that based upon the Auditor's examination, the percentage of underreporting is even higher. One possible exception is the month of November, although November is missing fifteen (15) days of Z-Tapes.

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only have a few days available for examination. March 2008 appears to be fairly complete. The months of April through June 2008 are missing. July 2008 is incomplete. August through October 2008 appear to be fairly complete. November 2008 is missing. December 2008 appears to be fairly complete. ALJ's Exhibit 2, PROT.000128-PROT.000459. *See* ALJ's Exhibit 2, PROT.000460-PROT.000966 and Division's Exhibit E.

[106] Tr. at 134-135.

[107] ALJ's Exhibit 2, PROT.000051.

[108] ALJ's Exhibit 2, PROT.000052.

[109] ALJ's Exhibit 2, PROT.000053.

[110] ALJ's Exhibit 2, PROT.000054.

SECTION B

THE "SUMMIT"
BASIS OF AUDIT MODEL
FOR INSIDE SALES
(ORIGINAL AND 1ST REVISION)

46. The Division uses a Taxpayer's records as its primary method of performing a sales tax "field audit" on a Convenience Store for "Inside Convenience Store Sales." Fuel is excluded. When records are not available the Division has defaulted in all audits on Convenience Stores to the NACS Computation based upon the "Summit."[111] At the time of the hearing, Auditor estimated she had defaulted to the NACS Computation based upon the "Summit" in approximately ninety percent (90%) of her sales tax audits on Convenience Stores because complete records were not available.[112]

47. The NACS State of the Industry Summit ("Summit Meeting") is an annual conference held in Chicago. "The [Summit Meeting] is the leading financial, operational and consumer view of the convenience store industry from a metrics and strategic review. *The [Summit Meeting] offers a first look at the numbers from a retailer's perspective coupled with expert commentary on what all the numbers mean.* All aspects of the economy, from the energy markets to the banking industry, as well as overall economic health are evaluated from the perspective of the convenience store industry."[113] (Emphasis added.)

48. The Division used the information contained in the "Summit" as the basis for the NACS Computation, which was then used to produce the proposed sales tax assessments for "Inside Convenience Store Sales" (Original and 1st Revision).[114]

49. The "Summit" itself is an "un-numbered" document consisting of seventy (70) pages, which appears to be from a "slide presentation" or "power point presentation," without any text explaining what the numbers mean. The "Summit" includes a cover sheet titled "NACS State of the Industry Summit, April 6-8, 2009 • Chicago, Illinois," a "Copyright Notice," "Disclaimer,"[115] and subject dividers, charts, and graphs, with notations as to the source of the

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[111] From the information contained in the record, it appears that the NACS Computation based upon the "Summit" and/or the 2008 NACS Annual Report has been used on all Convenience Store Audits up to the September 20th hearing, including all cases which have been protested, protests which have been docketed and which may or may not have already gone to hearing, and protests on which *Findings, Conclusions and Recommendations* have been issued and are awaiting a Commission Order.

[112] Tr. at 68.

[113] The Administrative Law Judge is taking judicial notice of the NACS website at http://www.nacsonline.com to complete the factual details and background of this matter. OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999). *See* 2008 NACS Annual Report at 8.

[114] Tr. at 71-72. *See* ALJ's Exhibit 4.

[115] *Id.* The Disclaimer states in pertinent part, as follows, to-wit:

data. The notations reflect that the sources of the data include, but are not exclusive of the "NACS State of the Industry Survey of 2008 data powered by CSX"[116] and "TDLinx, a service of the Nielsen Company."[117] The "Summit" also contains a chart titled "Methodology,"[118] which states, as follows, to-wit:

TABLE N

- **Data derived from annual NACS State of the Industry survey and CSX contributions**
  - **-- 156 retail firms with 20,553 stores as of December, 2008**
  - **-- Results reported are per store, per month**
  - **-- Figures reflect weighted average mean (based on store counts) of firms reporting each line**
  - **-- Focus on trends as opposed to specific values**
  - **-- Same firm basis allows apples to apples comparison over time**

50. During the discovery phase of this matter, the Division did not produce a copy of the "Summit" because it is copyrighted.[119] The Division *did have* a copy of the "Summit" available for "examination purposes only" during the September 20th hearing.[120] The Division obtained a copy of the "Summit" from someone (unnamed) who either attended the Summit Meeting[121] or had purchased a copy of the "Summit" and gave one of the auditors a copy.[122] The Tax Commission is not a member of NACS, but is considered a "friend of NACS."[123]

> …The National Association of Convenience Stores makes no warranty, express or implied, nor does it assume any legal liability or responsibility for the accuracy, completeness, or usefulness of any information, product, or process described in these materials.

[116] "…CSX, the industry's largest purpose-built, online database of financial and operating data. The CSX data analysis engine facilitates the quick and accurate creation of insightful reports on almost any cut of the data, so subscribers have the option of customizing their view of virtually any data element contained in this report." *See* 2008 NACS Annual Report at 4.

[117] "Where referenced, aggregated total industry figures were calculated using store counts from TDLinx, a service of The Nielsen Company. In reporting the combined size and scope of the industry, survey responses from participating firms were weighted using factors to normalize reported data to the composition of the industry." *See* 2008 NACS Annual Report at 4.

[118] ALJ's Exhibit 4, NACS000015.

[119] Tr. at 72.

[120] Tr. at 80.

[121] The conference and the publication are both referenced by the Division as the "Summit." Tr. at 72.

[122] Tr. at 81-82.

[123] *Id.* As a "Friend of NACS," the Tax Commission receives the NACS magazine and emails, but it is not a member. If the Division continues to use NACS as the basis of the Audit Model, the Tax Commission might consider becoming a member and purchasing the annual reports for 2007, 2008, 2009, 2010, and 2011.

51. The cornerstone of the NACS Computation is the Dollar Amount of 3.2 Beer Purchases made by a Convenience Store during an audit period. The Division states that it uses the Product Mix (Top Ten Categories, which includes 3.2 beer, and Other Categories) and the Margins for each of those categories as reflected in the "Summit," except the Margin for 3.2 beer. The Division has not been using the 2008, 3.2 Beer Margin (21.0%) from the "Summit," but has been using a Margin of 21.64%, which was calculated by "…AUDITOR 2, the auditor who prepared the original 2008 C-store worksheet."[124] The Dollar Amount of 3.2 Beer is entered by the Auditor and the Division states that the NACS Computation uses the Dollar Amount of 3.2 Beer Purchases and the Margin for 3.2 Beer and that the model extrapolates the Gross Dollars of Sales for all eleven (11) categories (Top Ten plus Other Categories). The Division then subtracts the Gross Dollars of Sales for Cigarettes and Other Tobacco Products because these two (2) categories are not subject to sales tax in the State of Oklahoma.[125]

52. The NACS Computation worksheets in all Convenience Store Audits (at least up to the date of hearing) contain an error in the column "Average Percent of Markup." The column should indicate "Margin" not "Markup."[126]

53. The Division cannot explain the differences in the "Margins" for the Product Mixes or the differences in the "Product Mixes" contained in the "Summit" versus the 2008 NACS State of the Industry Annual Report ("2008 NACS Annual Report").[127]

54. The Division has talked to somebody with NACS in person concerning the Division's use of NACS information in the NACS Computation ("Summit"). As stated by Audit Supervisor, "I have talked to somebody with NACS in person. They voiced their concerns that

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[124] Tr. at 75. *See* Division's Response to Administrative Law Judge's Request for Explanation of Division's Use of NACS to Compute Taxable Sales filed September 26, 2011, and attachments thereto. *See also* Division's Response to Administrative Law Judge's Request of September 30, 2011, filed October 5, 2011, and attachments thereto.

[125] Division's Exhibit I1 through I3. *See* Division's Workpapers in Support of Its Use of National Convenience Store Averages in Case No. P-09-188-H, *which were redacted and provided to Counsel at the hearing. See also* OTC Order No. 2010-08-17-03 (August 17, 2010) and *Table D*.

[126] Tr. at 73-80. The worksheets have contained the error since 2009. *See Table D* and Division's Exhibits I1 through I3. *See also* the redacted copy of *Division's Workpapers in Support of Its Use of National Convenience Store Averages* from Case No. P-09-188-H, which were provided to Counsel at the conclusion of the September 20th hearing. On the last page of the exhibit (P-09-188-H) the Division uses the following example to illustrate the difference between "Markup" and "Margin," as follows, to-wit:

THERE ARE TWO METHODS FOR FIGURING PROFIT: MARGIN OR MARKUP

EXAMPLES:	1,000.00 COST	21% MARKUP	$1000*1.21	$1,210.00
	1,000.00 COST	21% MARGIN	$1000/(1-.21)	$1,265.82

[127] Tr. at 74-75. The Administrative Law Judge informed Counsel during the September 20th hearing that judicial notice of the 2008 NACS Annual Report entered in Case No. P-11-233-K was being taken to complete the factual details and background of this audit. OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999). *See* Procedural History herein.

we may not have understood what the numbers indicated. We gave them the explanation as we have given here. If there are no records, insufficient records, or clearly erroneous records, we were looking for information to use, and that was what we were able to obtain. And they agreed that it was something that could be used at that point."[128]

55. According to the Audit Supervisor, over the last three (3) years, the Division defaulted to the NACS Computation ("Summit") in ninety-nine percent (99%) of "field" audits on Convenience Stores, after verifying that the Taxpayers' records were inadequate.[129]

SECTION C

3.2 BEER RECORDS
(HEARING AND POST-HEARING FILINGS)

56. There is no specific statute or Tax Commission Rule which requires Distributors to provide 3.2 beer purchase records annually or prescribes the form in which the Distributors report the information to the Tax Commission. The information the Tax Commission receives from Distributors is based upon "just a friendly agreement they made to help us, and they submit that annually."[130]

57. Distributors report to the Division "Annually" 3.2 beer purchase information electronically in the form of spread sheets. The information on the spread sheets can vary from Distributor to Distributor, and vary from year to year. Some provide a breakdown by month, the total number of cases, and total purchase amounts during a twelve (12) month period, while others provide only the total number of cases purchased and the total purchase amount. The Division determines from the spreadsheets "what information is relevant," cutting and pasting the information provided in its exhibits produced at hearing.[131]

58. On October 17, 2011, the Division's Submission of ALJ's Exhibit 3 was filed, which is copies of STORE's 3.2 beer purchases during the Audit Period, extracted from the "Master Reports," from 3.2 BEER DISTRIBUTOR ONE and 3.2 BEER DISTRIBUTOR TWO, including 2009 Non-Alcoholic purchases from 3.2 BEER DISTRIBUTOR TWO. "The reports submitted were taken from larger reports which include 'all' purchases from all purchasers during the year reflected. Some of the years' reports also contain columns for 'keg qty' and 'keg$' which have been deleted for purposes of this submission since there were no entries in either column for any year." The Division's "Master Reports" from 3.2 BEER DISTRIBUTOR TWO for 2008 and 2009 match the reports obtained by the Protestants. However, STORE's

[128] Tr. at 83.

[129] Tr. at 88.

[130] Tr. at 141-142.

[131] Division's Exhibit M13 through M15. Tr. at 139-141.

2007, 3.2 beer purchases extracted from **3.2 BEER DISTRIBUTOR TWO's 2007 "Master Report"** reflect the following, in pertinent parts,[132] to-wit:

Table O

Month	$Vol
April	3,410.93
May	4,822.93
June	5,350.15
July	3,353.84
August	4,711.99
September	3,283.06
October	3,577.22
November	4,449.19
December	4,588.32
2007 Totals	37,547.63

When ***3.2 BEER DISTRIBUTOR TWO's 2007 "Master Report"*** is compared with the 2007 Beer Report obtained by the Protestants from 3.2 BEER DISTRIBUTOR TWO,[133] ***the figures do not match. The Division's 2007 "Master Report"[134] for all purchasers does not exclude purchases/credits for "Non-Alcoholic"[135] and "Energy Drinks." For example, STORE purchased $37,600.00 of 3.2 beer from 3.2 BEER DISTRIBUTOR TWO (04/01/07-12/31/07) not $37,547.63.[136]***

[132] *Id.*

[133] ALJ's Exhibit 2, PROT.001027.

[134] ALJ's Exhibit 3.

[135] The category of "Non-Alcoholic" also includes the purchase of Welch's "Cranberry Cocktail," "Fruit Juice," "Orange Juice," "Apple Juice," and "Grape Juice." *See* ALJ's Exhibit 2, PROT.002383.

[136] Compare *Tables H* and *O*.

SECTION D

SELECTED ANNOUNCEMENTS MADE AT HEARING

DIVISION'S VERIFICATION OF 2008 NACS COMPUTATION BASED UPON THE "SUMMIT"

59. Counsel were advised by the Administrative Law Judge that judicial notice was being taken of OTC Order No. 2010-08-17-03 (August 17, 2010), which was the first Convenience Store protest based upon a NACS Computation resulting in a Commission Order. Counsel were given redacted copies of the Commission Order, the "Division's Workpapers in Support of its use of National Convenience Store Averages," and attachments thereto in Case No. P-09-188-H, which contained NACS information for 2003, 2005, and 2008.[137]

60. Counsel were advised by the Administrative Law Judge that "…based upon the testimony I've heard today, I simply don't understand how the Division's audit model works now with the 2008 report [2008 NACS Annual Report], because the testimony has been from [Audit Supervisor] that she cannot explain the differences in the percentages between the report [Summit] that it has, that's suppose to be the 2008, versus the full copy of the 2008 report that ATTORNEY 1 submitted in ALJ 2'S case, 11-233-K… In addition, [Audit Supervisor] testified that she made adjustments to the audit model to take into account the fact that convenience stores in Oklahoma do not sell wine or liquor, which are included in the categories according to the 2008 NACS reports. Further, the original audit model was based upon the NACS top ten categories. Those categories have changed according to the 2008 NACS report. …I'm going to request that the Division submit a post-hearing brief to explain and attach exhibits in the same light as what I've provided to counsel that I'm taking judicial notice of on the very first NACS audit that I heard on a convenience store, because at this point I simply don't know how the 2008 ["Summit"] model works…until it's clear in my mind and the Division has shown by substantial evidence that the 2008 ["Summit"] model is what it purports to be, I don't feel comfortable with going forward…."[138]

[137] Tr. at 145-146.

[138] Tr. at 146-150.

SECTION E

SELECTED POST-HEARING FILINGS THROUGH CLOSING OF RECORD

61. On September 26, 2011, the Division's Response to Administrative Law Judge's Request for Explanation of Division's Use of NACS to Compute Taxable Sales was filed with a three (3) page Memorandum from Audit Supervisor, with Exhibits A through O attached thereto. At hearing Audit Supervisor could not explain why the Margin for 3.2 beer (21.64%) did not match the "Summit" or the 2008 NACS Annual Report.[139] In the Memorandum attached to this pleading Audit Supervisor states, "This percentage of 21.64% utilized by the form is actually the weighted average or rounding of beer margins from NACS data for previous years (2005 and 2006)."[140] In a Memorandum attached to the Division's October 5th filing, Audit Supervisor states, "After speaking with AUDITOR 2 [AUDITOR 2] again and reviewing the actual calculations resulting in the 21.64% margin used on the original 2008 C-Store worksheet, I realized that I misspoke when stating that I believed that it was from 2005 and 2006 data. While the 2005 and 2006 do average 21.6%, AUDITOR 2 [AUDITOR 2], the auditor who created the original 2008 form, provided me the attached calculation which illustrates how the 21.64% margin was calculated."[141]

62. On October 11, 2011, the Division filed a copy of the "Summit," with "Bates" numbers added by the Division ("NACS000001-NACS000070).[142]

63. On October 17, 2011, the Division's Notice of Sales Tax Revision ("2nd Revision") was filed ***reflecting the removal of "Hot Food."***[143] The Division used the Margins from the ***2008 NACS Annual Report, instead of the "Summit," including the "Summit's" 3.2 Beer Margin (20.96%).*** The Division notes, "…that although the margins differ slightly from the margins reflected on Exhibits 'B1' through 'B3', the 'total unreported sales per worksheet' reflected for each year is the same."[144] Using the 2008 NACS Annual Report as the basis of the NACS Computation, STORE had Unreported Taxable Sales during the Audit Period,[145] as follows, to-wit:

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[139] Tr. at 75-76. *See* ALJ's Exhibit 4, NACS000038 and 2008 NACS Annual Report at 60.

[140] *See* Division's Response to Administrative Law Judge's Request for Explanation of Division's Use of NACS to Compute Taxable Sales, filed September 26, 2011.

[141] *See* Division's Response to Administrative Law Judge's Request of September 30, 2011, filed October 5, 2011. *See also Issues, Section III, Issue Two at 74, footnote 253.*

[142] ALJ's Exhibit 4.

[143] Compliance Division's Notice of Sales Tax Revision filed October 17, 2011, Exhibits C1 through C3.

[144] *Id.*

[145] *Id.* Only one (1) of the three (3) worksheets (C1) for the Audit Period has been "reproduced" for illustration purposes to compare and contrast this worksheet with other worksheets contained herein.

TABLE P

CONVENIENCE STORE WORKSHEET BASED UPON 2008 NACS INFORMATION
[2008 NACS Annual Report]

MARGINS CORRECTED TO 2008 NACS PG 60
BEER PURCHASES MONTHS/YEAR 4/01/07 thru 12/31/07

INFO FROM 2008 NACS

3.2 BEER PURCHASES	ITEMS	NACS MARGIN IN %	USE ALL NACS P-MIX (Y/N)	SALES
	CIGARETTES	0.1530	0.3490	545,371.48
	FOODSERVICE:			
	PREPARED FOOD ON SITE (HOT FOOD)	0.47900	0.0000	0.00
	PKG PREPARED FOOD PROD	0.35300	0.0395	61,708.70
	HOT BEVERAGE	0.6490	0.0171	26,684.84
	COLD BEVERAGE	0.465	0.0128	20,013.63
	FROZEN BEVERAGE	0.469	0.0117	18,345.83
	PACKAGE BEVERAGE	0.4020	0.1505	235,160.18
134,391.54	BEER	0.2100	0.1089	170,115.87
	GEN MERCH	0.3930	0.0149	23,349.24
	CANDY	0.5030	0.0342	53,369.69
	SALTY SNACKS	0.3760	0.0374	58,373.09
	OTHER TOBACCO	0.3110	0.0416	65,044.30
	FLUID MILK PROD	0.2820	0.0331	51,701.88
	PACKAGE SWEET SNACKS	0.3390	0.0277	43,362.87
	OTHER DEPT***	0.4171	0.1217	190,129.51
			1.0000	1,562,731.11

CIG/TOB NON TAXABLE	(610,415.78)
LESS REPORTED NET TAXABLE SALES	(114,894.00)
LESS FOOD STAMPS	
LESS MAG/NEWS	
TOTAL UNREPORTED SALES PER WORKSHEET	837,421.33

*2008 P-MIX BASED ON INSIDE SALE CONTRIBUTION – NACS/CSX AVERAGE MONTHLY SALES = $114,010 (2008)
**2008 MARGIN IS FROM TOP TEN MERCHANDISE CATEGORIES SORTED BY PRODUCT, NACS/CSX AVERAGE
***** THERE IS NO EXPLANATION ON ANY OF THE WORKSHEETS**
BEER IS 10.2 OF ALL INSIDE SALES INCLUDING CIGARETTES AND OTP

April 1, 2007 through December 31, 2007	$ 837,421.33
2008 Tax Year	1,159,948.89
2009 Tax Year	974,558.83
Total Underreported Sales	$2,971,929.05

Sales Tax:	$240,190.73
Interest to 09/20/2011:	94,059.81
Penalty:	24,019.09
Total:	$358,269.63

64. On October 19, 2011, the Administrative Law Judge requested the Division to provide information, to supplement its 2nd Revision,[146] as follows, to-wit:

> 1. Using the Worksheets attached as Exhibits C1 through C3, produce Worksheets using all NACS P-Mix (do not take out hot food). I want both scenarios available using the same model.

65. On October 20, 2011, the *Division's Response to Administrative Law Judge's Request for Additional CSGS Worksheets Which Include All of the NACS Product Mixes,* ***including "Hot Food,"***[147] was filed as follows, to-wit:

[146] *See* Division's Response to Administrative Law Judge's Request for Additional CSGS Worksheets Which Include All of the NACS Product Mixes filed October 20, 2011. Only C4 has been reproduced for illustration purposes to compare and contrast to other worksheets "reproduced" herein.

[147] *Id.*

TABLE Q

CONVENIENCE STORE WORKSHEET BASED UPON 2008 NACS INFORMATION
[2008 NACS Annual Report]

MARGINS CORRECTED TO 2008 NACS PG 60
BEER PURCHASES MONTHS/YEAR 4/01/07 thru 12/31/07

INFO FROM 2008 NACS

3.2 BEER PURCHASES	ITEMS	NACS MARGIN IN %	USE ALL NACS P-MIX (Y/N)	SALES
	CIGARETTES	0.1530	0.3270	545,371.48
	FOODSERVICE:			
	PREPARED FOOD ON SITE (HOT FOOD)	0.47900	0.0629	104,836.41
	PKG PREPARED FOOD PRODUCTS	0.35300	0.0374	62,334.13
	HOT BEVERAGE	0.6490	0.0158	26,411.32
	COLD BEVERAGE	0.465	0.0120	19,933.58
	FROZEN BEVERAGE	0.469	0.0110	18,309.14
	PACKAGE BEVERAGE	0.4020	0.1410	235,160.18
134,391.54	BEER	0.2100	0.1020	170,115.87
	GEN MERCH	0.3930	0.0140	23,349.24
	CANDY	0.5030	0.0320	53,369.69
	SALTY SNACKS	0.3760	0.0350	58,373.09
	OTHER TOBACCO	0.3110	0.0390	65,044.30
	FLUID MILK PROD	0.2820	0.0310	51,701.88
	PACKAGE SWEET SNACKS	0.3390	0.0260	43,362.87
	OTHER DEPT***	0.4171	0.1140	190,129.51
			1.0000	1,667,802.68

CIG/TOB NON TAXABLE	(610,415.78)
LESS REPORTED NET TAXABLE SALES	(114,894.00)
LESS FOOD STAMPS	
LESS MAG/NEWS	
TOTAL UNREPORTED SALES PER WORKSHEET	942,492.90

*2008 P-MIX BASED ON INSIDE SALE CONTRIBUTION – NACS/CSX AVERAGE MONTHLY SALES = $114,010 (2008)
**2008 MARGIN IS FROM TOP TEN MERCHANDISE CATEGORIES SORTED BY PRODUCT, NACS/CSX AVERAGE
***** THERE IS NO EXPLANATION ON ANY OF THE WORKSHEETS**
BEER IS 10.2 OF ALL INSIDE SALES INCLUDING CIGARETTES AND OTP

April 1, 2007 through December 31, 2007	$ 942,492.90	
2008 Tax Year	1,305,262.85	
2009 Tax Year	1,097,236.91	
Total Underreported Sales	$3,344,992.66	WITH HOT FOOD
Total Underreported Sales	2,971,929.05	W/O HOT FOOD
Difference Underreported Sales	$ 373,063.61	Audit Period

SECTION F

2008 NACS ANNUAL REPORT

66. The Division did not have a copy of the 2008 NACS Annual Report until it was introduced into evidence as an exhibit at the hearing held in Case No. P-11-233-K on September 13, 2011.[148]

67. The 2008 NACS Annual Report Methodology[149] is stated in pertinent parts, as follows, to-wit:

TABLE R

> …All figures in this report, except where noted, are based on data submitted by retail companies participating in the annual NACS State of the Industry survey, which was open from December 2008 until April 2009.
>
> The engine that drives the annual State of the Industry Report is CSX, the industry's largest purpose-built, online database of financial and operating data. The CSX data analysis engine facilitates the quick and accurate creation of insightful reports on almost any cut of the data, so subscribers have the option of customizing their view of virtually any data element contained in this report…
>
> Where referenced, aggregated total industry figures were calculated using store counts from TDLinx, a service of The Nielsen Company. In reporting the combined size and scope of the industry, *survey responses from participating firms were weighted using factors to normalize reported data to the composition of the industry.* However, as evidenced by the State of the Industry Survey Table…there was a significant variance between the numbers of 1-10 store operators submitting information to NACS versus the number of these operations reported by Nielson. Further, because firms in the survey response pool change from year to year, we elected to present firm data in a non-normalized format as of last year's report.
>
> Not normalizing surveyed firm data to the industry store census significantly enhances the ability to benchmark actual retail performance to the metrics presented in this report, as only surveyed data from real firms is used. Total industry, aggregated values are only used in explicitly stated sections – Highlights, Industry Outlook and Merchandise – so the shift in methodology should not encumber benchmarking efforts.… (Emphasis added.)

[148] Tr. at 80-81. *See* Procedural History in P-11-233-K. The 2008 NACS Annual Report consists of an Introduction, Acknowledgements, Foreword & Methodology, and NACS Summary (Table of Contents), text, charts, and graphs (6-169), NACS Glossary (170-171), and Index (173-175).

[149] *Id. See* 2008 NACS Annual Report at 4.

68. NACS defines a "Convenience Store" as a retail business that provides the public with a convenient location to quickly purchase a wide variety of consumable products and services, generally food and gasoline. *While not fixed requirements*, convenience stores have the following general characteristics:

TABLE S

1. Building size of less than 5,000 square feet.
2. Off-street parking and/or convenient pedestrian access.
3. Extended hours of operation, with many open 24 hours, seven days a week.
4. Offer at least 500 stock keeping units (SKUs).
5. Product mix includes a significant selection of tobacco, beverages, snacks, candy and grocery items.[150] (Emphasis added.)

69. In 2008, the typical Convenience Store occupied 2,696 square feet of space,[151] or approximately $42.14 per square foot for "Average Monthly In-Store Sales" of $114,010.00.[152]

70. The Top Ten Sales Categories ranked by "Gross Profit Dollar Contribution" (87.02%)[153] are as follows, to-wit:

TABLE T

Top Ten Sales Categories	% of In-Store Sales
Packaged Beverages	15.57%
Cigarettes	32.91%
Food Prepared On-Site	8.83%
Hot Dispensed Beverages	5.25%
Beer[154]	10.14%
Candy	3.09%
Salty Snacks	3.95%
Other Tobacco Products	3.42%
Cold Dispensed Beverages	1.68%
Fluid Milk Products	2.18%
	87.02%

The "aggregate" of the remaining twenty-two (22) "Other Categories" account for 12.98% of Gross Profit Dollar Contribution.[155] What comprises the remaining twenty-two (22) "Other Categories" is not specifically indicated in the 2008 NACS Annual Report.

[150] *See* 2008 NACS Annual Report at 6.

[151] *See* 2008 NACS Annual Report at 112-113. *See also Issues, Section IV at 74.*

[152] *Id.*

[153] *See* 2008 NACS Annual Report at 57.

[154] 3.2 beer is divided into subcategories. *See* 2008 NACS Annual Report at 61.

[155] *Id. See* 2008 NACS Annual Report at 56.

71. The Product Mix of In-Store Sales for 2008, with the Top Ten Categories highlighted,[156] are as follows, to-wit:

TABLE U

PRODUCT MIX
MERCHANDISE

Cigarettes	32.91%
Other Tobacco	3.42%
Beer	10.14%
Wine	0.40%
Liquor	0.28%
Packaged Beverages	15.57%
Candy	3.09%
Salty Snacks	3.95%
Packaged Sweet Snacks	2.12%
Alternative Snacks	1.68%
Frozen Foods	0.24%
Packaged Ice Cream/Novelties	1.30%
Ice	0.69%
Edible Grocery	0.81%
Non-Edible Grocery	0.37%
Perishable Grocery	0.31%
Fluid Milk Products	2.18%
Other Dairy and Deli	0.58%
Packaged Bread	0.61%
Health and Beauty	1.32%
Automotive Products	0.55%
Publications	1.47%
General Merchandise	1.35%
Subtotal	85.34%

PRODUCT MIX
FOODSERVICE

Food Prepared On-Site ("Hot Food")[157]	8.83%
Commissary/Packaged Sandwiches	0.74%
Hot Dispensed Beverages	5.25%
Cold Dispensed Beverages	1.68%
Frozen Beverages	0.26%
Subtotal	15.22%[158]
Total In-Store	100.56%

[156] *See* 2008 NACS Annual Report at 59.

[157] According to the NACS website at http://www.nacsonline.com/NACS/Resources this category includes, but not exclusive of such items as chicken, pizza, hot dogs/roller grill products, and hamburgers. *See* NACS Category Definitions and Numbering Guide – Version 7.0 at 7. *See also* OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999).

[158] Foodservice adds up to 16.76%, not 15.22%, which is attributable to how NACS performed the calculation.

72. The Gross Margin Percentage of In-Store Sales[159] for 2008, with the Top Ten Categories highlighted, are stated as follows,[160] to-wit:

[159] *Id.* According to the NACS Glossary, Gross Margin Percent is defined as "The weighted overall average price minus the weighted overall average cost divided by the weighted cost."

[160] *Id.* *See* 2008 NACS Annual Report at 60. The report breaks down each category by subcategory. *See also* 2008 NACS Annual Report at 61-64.

TABLE V

MARGINS

MERCHANDISE

Cigarettes	15.33%[161]
Other Tobacco	31.11%[162]
Beer	20.96%
Wine	28.15%[163]
Liquor	26.53%[164]
Packaged Beverages	40.15%
Candy	50.27%
Salty Snacks	37.62%
Packaged Sweet Snacks	33.91%
Alternative Snacks	42.94%
Frozen Foods	41.89%
Packaged Ice Cream/Novelties	46.91%
Ice	62.12%
Edible Grocery	44.14%
Non-Edible Grocery	39.42%
Perishable Grocery	37.20%
Fluid Milk Products	28.20%
Other Dairy and Deli	38.44%
Packaged Bread	36.13%
Health and Beauty	49.94%
Automotive Products	38.98%
Publications	22.64%[165]
General Merchandise	39.31%[166]
Subtotal	28.14%[167]

[161] Cigarettes and Other Tobacco Products are exempt from the imposition of sales tax in the State of Oklahoma. *See Oklahoma Cigarette Act and Oklahoma Tobacco Act*, OKLA. STAT. ANN. tit. 68, § 201 *et seq.* (West 2001) and § 301 *et seq.* (West 2001), respectively.

[162] *Id.*

[163] As with grocery stores, Wine and Liquor cannot be sold by Convenience Stores in the State of Oklahoma.

[164] *Id.*

[165] "Publications" consists of Newspapers, Magazines/Tabloids, Adult Magazines, Paperbacks/Books, Comics, Traders, Maps, and Other Publications. *See* 2008 NACS Annual Report at 62. The sales of newspapers and periodicals are exempt from sales and use tax, regardless of whether purchased by single copy or subscription. *See also* OKLA. ADMIN. CODE § 710:65-13-190. The test for determining what is considered a newspaper or periodical is contained in the Tax Commission Rule. If the publication is determined to be a book, it is subject to the imposition of sales tax.

[166] "General Merchandise" consists of items such as Batteries, Film/Photo, School/Office Supplies, Greeting/Gift/Novelties/Toys/Recreational Equipment, Trading Cards, Wearables/Apparel, Smoking Accessories, Video/Audio Tapes, Hardware/Tools/Housewares, Floral, Seasonal GM, Other GM, Telecommunications Hardware, and Propane Exchanges. *See* 2008 NACS Annual Report at 63.

[167] The percentage is attributable to how NACS performed the calculation.

MARGINS
FOODSERVICE

Food Prepared On-Site ("Hot Food")	47.92%
Commissary/Packaged Sandwiches	35.25%
Hot Dispensed Beverages	64.94%
Cold Dispensed Beverages	46.53%
Frozen Beverages	46.90%
Subtotal	52.14%
Total In-Store	31.98%[168]

73. According to NACS, for 2008 the percentage of Convenience Stores selling Alcoholic Beverages "Nationally"[169] is as follows, to-wit:

TABLE W

Beer	77.20%
Wine	39.16%
Liquor	21.44%

74. "Other Store Operating Income" is comprised of services and goods such as Carwashes, Other Automotive Services, Games/Amusements, Lottery/Lotto Commissions,[170] ATM Revenue, Check Cashing, Money Order Commissions, Telephone Commissions, Prepaid Telecommunications, Other Prepaid Cards, Motor Fuel Image Allowance, and Other Miscellaneous, which are usually not subject to the imposition of sales tax.[171] However, in the State of Oklahoma, "The sale of a prepaid telephone calling card, prepaid telephone authorization number, or the recharge of a prepaid calling card or authorization number is subject to sales tax at the point of sale by the retail vendor."[172]

75. According to NACS, "Other Income – Fee based only" is not a "Merchandise" category.[173]

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[168] *Id.*

[169] *See* 2008 NACS Annual Report at 83.

[170] The sales of Lottery Tickets are exempt from the imposition of sales tax. *See* OKLA. ADMIN. CODE § 710:65-19-195 (June 25, 2006) and OKLA. STAT. ANN. tit. 3A, § 717 (West 2011).

[171] *See* 2008 NACS Annual Report at 50 and 166.

[172] OKLA. ADMIN. CODE § 710:65-19-331 (June 11, 2005).

[173] *See* NACS website at http://www.nacsonline.com/NACS/Resources, Category Definitions and Numbering Guide – Version 7.0 at 6. *See also* OKLA. ADMIN. CODE § 710:1-5-36 (June 25, 1999).

CONCLUSIONS OF LAW

1. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding.[174]

2. The collection and remittance of sales tax is governed by the Oklahoma Sales Tax Code ("Sales Tax Code").[175] The Sales Tax Code levies "upon all sales,[176] not otherwise exempted…an excise tax of four and one-half percent (4.5%) of the gross receipts or gross proceeds[177] of each sale of…tangible personal property…," and specifically, the sale of "[n]atural or artificial gas,…."[178] Oklahoma Statutes authorize incorporated cities, towns, and counties to levy taxes as the Legislature may levy and collect taxes for purposes of state government.[179]

3. Section 1365(A) of Title 68,[180] provides:

> The tax levied hereunder shall be due and payable on the first day of each month, except as herein provided, by any person liable to remit or pay any tax due under Section 1350 et seq. [Sales Tax Code] of this title. For the purpose of ascertaining the amount of the tax payable, it shall be the duty of all tax remitters, on or before the twentieth day of each month, to deliver to the Oklahoma Tax Commission, *upon forms prescribed and furnished by it, sales tax reports signed under oath*, showing the gross receipts or gross proceeds arising from all sales taxable or nontaxable under Section 1350 et seq. of this

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[174] OKLA. STAT. ANN. tit. 68, § 221(D) (West Supp. 2012).

[175] OKLA. STAT. ANN. tit. 68, § 1350 *et seq.* (West 2008).

[176] OKLA. STAT. ANN. tit. 68, § 1352(22)(a) and (b) (West 2008):

> "Sale" means 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, or other transactions as provided by this paragraph, including but not limited to:
>
> a. the exchange, barter, lease, or rental of tangible personal property resulting in the transfer of the title to or possession of the property,
>
> b. the disposition for consumption or use in any business or by any person of all goods, wares, merchandise, or property which has been purchased for resale, manufacturing, or further processing,
>
> …

[177] OKLA. STAT. ANN. tit. 68, § 1352(12) (West 2008).

[178] OKLA. STAT. ANN. tit. 68, § 1354(A)(1) and (2) (West 2008). *See* OKLA. ADMIN. CODE § 710:65-13-120.

[179] OKLA. STAT. ANN. tit. 68, § 1370 *et seq.* (West 2008). *See* OKLA. STAT. tit. 68, § 2701 (West Supp. 2012).

[180] OKLA. STAT. ANN. tit. 68, § 1365(A) (West 2008). OKLA. ADMIN. CODE § 710:65-3-6.

> title during the preceding calendar month. Such reports shall show such further information as the Tax Commission may require to enable it to compute correctly and collect the tax herein levied. In addition to the information required on reports, the Tax Commission may request and the taxpayer must furnish any information deemed necessary for a correct computation of the tax levied herein. Such tax remitter shall compute and remit to the Tax Commission the required tax due for the preceding calendar month, the remittance or remittances of the tax to accompany the reports herein required. If not filed on or before the twentieth day of such month, the tax shall be delinquent from such date. Reports timely mailed shall be considered timely filed. If a report is not timely filed, interest shall be charged from the date the report should have been filed until the report is actually filed. (Emphasis added.)

4. Reports or returns or other matter which are required by law to be verified by oath or affirmation and filed with the Tax Commission may be verified by oath or affirmation taken before a person authorized to administer oaths, *or by a declaration in writing that the report or return or other matter is signed under the penalties of perjury.* The fact that a report or return or other matter purports to have been signed by a person shall for all purposes be prima facie evidence that he in fact signed the report or return or other matter.[181]

5. It shall be the duty of every tax remitter required to make a sales tax report and pay any tax under the Oklahoma Sales Tax Code[182] to keep and preserve suitable records of the gross daily sales together with invoices of purchases and sales, bills of lading, bills of sale and other pertinent records and documents which may be necessary to determine the amount of tax due hereunder and such other records of goods, wares and merchandise, and other subjects of taxation under the Oklahoma Sales Tax Code[183] as will substantiate and prove the accuracy of such returns. It shall also be the duty of every person who makes sales for resale to keep records of such sales which shall be subject to examination by the Tax Commission or any authorized employee thereof while engaged in checking or auditing the records of any person required to

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[181] OKLA. STAT. ANN. tit. 68, § 245 (West 2001). An interesting side-note, when you look above the signature line of an Oklahoma Sales Tax Report (Form 13-23) the following language appears:

> I declare that the information in this document and any attachments is true and correct to the best of my knowledge and belief.

Contrast that with the language above the signature line of an Oklahoma Income Tax Return (Form 511):

> Under penalty of perjury, I declare the information contained in this document and any attachments is true and correct to the best of my knowledge and belief.

The language above the signature line of the Oklahoma Sales Tax Report (Form 13-23) does not appear to conform to statutory requirements or Tax Commission Rule. It is unknown how the requirement is addressed with the on-line filing system. *Conclusions of Law 3-4, and the footnotes thereto.*

[182] OKLA. STAT. ANN. tit. 68, § 1350 *et seq.* (West 2008).

[183] *Id.*

make a report under the terms of the Oklahoma Sales Tax Code.[184] All such records shall remain in Oklahoma and be preserved for a period of three (3) years, unless the Tax Commission, in writing, has authorized their destruction or disposal at an earlier date, and shall be open to examination at any time by the Tax Commission or by any of its duly authorized agents. The burden of proving that a sale was not a taxable sale shall be upon the person who made the sale.[185]

6. If any taxpayer shall fail to make any report or return as required by any state tax law, the Oklahoma Tax Commission, from any information in its possession or obtainable by it, may determine the correct amount of tax for the taxable period. If a report or return has been filed, the Tax Commission shall examine such report or return and make such audit or investigation as it may deem necessary. If, in cases where no report or return has been filed, the Tax Commission determines that there is a tax due for the taxable period, or if, in cases where a report or return has been filed, the Tax Commission shall determine that the tax disclosed by such report or return is less than the tax disclosed by its examination, it shall in writing propose the assessment of taxes or additional taxes, as the case may be, and shall mail a copy of the proposed assessment to the taxpayer at the taxpayer's last-known address. Proposed assessments made in the name of the "Oklahoma Tax Commission" by its authorized agents shall be considered as the action of the Tax Commission.[186]

7. When the Tax Commission issues a proposed assessment against a corporation for unpaid sales tax, the Commission shall file assessments against the principal officers of the corporation personally liable for the tax. The principal officers of any corporation shall be liable for the payment of any tax as prescribed by this section if such officers were officers of the corporation during the period of time for which the assessment was made. The liability of a principal officer for sales tax, withheld income tax or motor fuel tax shall be determined in accordance with the standards for determining liability for payment of federal withholding tax pursuant to the Internal Revenue Code of 1986, as amended, or regulations promulgated pursuant to such section.[187] From the record, there is no dispute that President was (and is) the principal and sole officer of STORE and responsible for the filing and remittance of sales tax during the Audit Period.[188]

8. The Tax Commission shall also collect interest at the rate of one and one-quarter percent (1¼%) per month from the date prescribed by state law.[189]

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[184] *Id.*

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

[186] OKLA. STAT. ANN. tit. 68, § 221(A) (West Supp. 2012).

[187] *See* OKLA. STAT. ANN. tit. 68, § 253 (West 2001) and OKLA. ADMIN. CODE § 710:65-5-5(d) (May 15, 2006).

[188] *See Findings of Fact 1*and *45.*

[189] OKLA. STAT. ANN. tit. 68, § 217(B) (West 2001).

9. If any tax due under any state tax law is not paid within thirty (30) days after such tax becomes delinquent, a penalty of ten percent (10%) on the total amount of tax due and delinquent shall be added thereto, collected and paid.[190]

10. If any part of any deficiency, arbitrary or jeopardy assessment made by the Tax Commission is based upon or occasioned by the taxpayer's negligence or by the failure or refusal of any taxpayer to file with the Tax Commission any report or return, as required by this title, or by any state tax law, within ten (10) days after a written demand for such report or return has been served upon any taxpayer by the Tax Commission by letter, the Tax Commission may assess and collect, as a penalty, twenty-five percent (25%) of the amount of the assessment. For purposes of this subsection, "negligence" shall mean the consistent understatement of income, consistent understatement of receipts or a system of recordkeeping by the taxpayer that consistently results in an inaccurate reporting of tax liability.[191]

11. If any part of any deficiency is due to fraud with intent to evade tax, then fifty percent (50%) of the total amount of the deficiency, in addition to such deficiency, including interest as herein provided, shall be added, collected and paid.[192]

12. No assessment of any tax levied under the provisions of any state tax law except as provided in this section, shall be made after the expiration of three (3) years from the date the return was required to be filed or the date the return was filed, whichever period expires the later, and no proceedings by tax warrant or in court without the previous assessment for the collection of such tax shall be begun after the expiration of such period. No assessment shall be required if a report or return, signed by the taxpayer, was filed and the liability evidenced by the report or return has not been paid. If the assessment has been made within the limitation period set forth in this subsection, the tax may be collected by tax warrant or court proceeding, but only if the tax warrant is issued or the proceeding begun within ten (10) years after the assessment of the tax has become final.[193]

13. In the case of a false or fraudulent report or return, with intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time. The term "false or fraudulent" as used in this subsection shall have the same meaning as when used in Section 6501 of the Internal Revenue Code.[194]

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[190] OKLA. STAT. ANN. tit. 68, § 217(D) (West Supp. 2012).

[191] OKLA. STAT. ANN. tit. 68, § 217(E) (West Supp. 2012).

[192] OKLA. STAT. ANN. tit. 68, § 217(F) (West Supp. 2012).

[193] OKLA. STAT. ANN. tit. 68, § 223(A) (West Supp. 2012).

[194] OKLA. STAT. ANN. tit. 68, § 223(C) (West Supp. 2012). *See* 26 U.S.C.A. § 6501(c), which provides in pertinent parts, as follows, to-wit:

14. The Oklahoma Tax Commission is hereby authorized to enforce the provisions of the *Uniform Tax Procedure Code*[195] and to promulgate and enforce any reasonable rules with respect thereto. The Tax Commission may also prescribe, promulgate and enforce all necessary rules for the purpose of making and filing of all reports required under any state tax law, and such rules as may be necessary to ascertain and compute the tax payable by any taxpayer subject to taxation under any state tax law; and may, at all times, exercise such authority as may be necessary to administer and enforce each and every provision of any state tax law.[196]

15. The rules promulgated pursuant to the Administrative Procedures Act[197] are presumed to be valid and binding on the persons they affect and have the force of law.[198]

16. In sales tax matters, "[t]he burden of proving a sale was not a taxable sale shall be upon the person who made the sale."[199]

> **Exceptions.—**
>
> **(1) False return.**--In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.
>
> **(2) Willful attempt to evade tax.**--In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. (Emphasis original.)
>
> …

[195] OKLA. STAT. ANN. tit. 68, § 201 *et seq.* (West 2001).

[196] OKLA. STAT. ANN. tit. 68, § 203 (West Supp. 2012.)

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

[198] *See Toxic Waste Impact Group, Inc. v. Leavitt*, 1988 OK 20, 755 P.2d 626.

[199] OKLA. STAT. ANN. tit. 68, § 1365(F) (West 2008):

> It shall be the duty of every tax remitter required to make a sales tax report and pay any tax under Section 1350 et seq. of this title to keep and preserve suitable records of the gross daily sales together with invoices of purchases and sales, bills of lading, bills of sale and other pertinent records and documents which may be necessary to determine the amount of tax due hereunder and such other records of goods, wares and merchandise, and other subjects of taxation under Section 1350 et seq. of this title as will substantiate and prove the accuracy of such returns. It shall also be the duty of every person who makes sales for resale to keep records of such sales which shall be subject to examination by the Tax Commission or any authorized employee thereof while engaged in checking or auditing the records of any person required to make a report under the terms of Section 1350 et seq. of this title. All such records shall remain in Oklahoma and be preserved for a period of three (3) years, unless the Tax Commission, in writing, has authorized their destruction or disposal at an earlier date, and shall be open to examination at any time by the Tax Commission or by any of its duly authorized agents. The burden of proving that a sale was not a taxable sale shall be upon the person who made the sale.

17. Although the Tax Commission is not required to comply with provisions of the Administrative Procedures Act ("APA"),[200] 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.[201]

18. 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.[202]

19. 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.[203]

20. Failure to provide notice of the specific issues in administrative hearings violates procedural due process.[204]

21. "Rules" are actions in which administrative agency's legislative element predominates, while "orders" involve more of judicial function and deal with particular present situation.[205]

22. Choice to proceed by general rulemaking or by individual ad hoc litigation lies primarily within informed discretion of administrative agency.[206]

23. Court of Appeals affords great deference to administrative agency action and will not disturb agency order unless it is "arbitrary and capricious," that is, not founded on reason.[207]

24. In all proceedings before the Tax Commission, the taxpayer has the burden of proof.[208]

See OKLA. ADMIN. CODE § 710:65-1-4 (June 26, 1994).

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

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

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

[203] *Id.*

[204] *Id.*

[205] *El Paso Natural Gas Co. v. Oklahoma Tax Com'n*, 1996 OK CIV APP 69, 929 P.2d 1002.

[206] *Id.*

[207] *Id.*

[208] OKLA. ADMIN. CODE § 710:1-5-47 (June 25, 1999):

25. A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect and in what respect.[209]

26. The Oklahoma Tax Commission is vested with jurisdiction over the parties and subject matter of this proceeding pursuant to Section 941(B) of Title 12,[210] which states as follows, to-wit:

> B. The respondent in any proceeding brought before any state administrative tribunal by any state agency, board, commission, department, authority or bureau authorized to make rules or formulate orders shall be entitled to recover against such state entity court costs, witness fees and reasonable attorney fees if the tribunal or a court of proper jurisdiction determines that the proceeding was brought without reasonable basis or is frivolous; provided, however, if the tribunal is required by law to act upon complaints and determines that the complaint had no reasonable basis or is frivolous, the tribunal may assess the respondent's costs, witness fees and reasonable attorney fees against the complainant. This subsection shall apply to any proceeding before any state administrative tribunal commenced on or after November 1, 1987.

27. Attorney's fees ordinarily are not recoverable in absence of a statutory authority or enforceable contract.[211] In action in which it is a party in its own courts, State is not liable for costs unless expressly provided by statute.[212]

> In all administrative proceedings, unless otherwise provided by law, the burden of proof shall be upon the protestant to show in what respect the action or proposed action of the Tax Commission is incorrect. If, upon hearing, the protestant fails to prove a prima facie case, the Administrative Law Judge may recommend that the Commission deny the protest solely upon the grounds of failure to prove sufficient facts which would entitle the protestant to the requested relief.

OKLA. ADMIN. CODE § 710:1-5-77(b) (June 25, 1999), provides in pertinent part:

> . . . "preponderance of the evidence" means the evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; evidence which as a whole shows that the fact sought to be proved is more probable than not.

[209] *See Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Com'n*, 1988 OK 91, 768 P.2d 359.

[210] OKLA. STAT. tit. 12, § 941(B) (West 2000).

[211] *See* "American rule." 1. The general policy that all litigants, even the prevailing one, must bear their own attorney's fees. The rule is subject to bad-faith and other statutory and contractual exceptions.… BLACK'S LAW DICTIONARY (8th ed. 2004), available at *http://westlaw.com*.

[212] *State ex rel. Oklahoma Dept. of Public Safety v. Five Thousand Eight Hundred Nine Dollars ($5,809.00) in U.S. Currency*, 1991 OK CIV APP 82, 817 P.2d 750.

28. Statute stating that respondent in any proceeding brought before state administrative tribunal by state agency shall be entitled to recover against such state entity attorney's fees if tribunal determines that proceeding was brought without reasonable basis is intended to be a check on the power of state agencies to commence civil or administrative proceedings against private parties.[213]

29. Statute dealing with attorney's fees in actions by state entities applies only to action by state.[214]

30. The burden of proof to show the requested attorney's fees are authorized is upon the moving party.[215]

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 opportunity to controvert them.[216] 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,[217] that the protestants did not keep all of the records required by statute[218] or by Tax Commission Rule.[219] Protestant also concedes that he had underreported on his sales tax report for most of the months of the audit period.[220] 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

[213] *Shackelford v. Oklahoma Military Department*, 1996 OK CIV APP 13, 919, P.2d 448.

[214] *State ex rel Dept. of Human Services on Behalf of Michael Aaron by McBride v. Perkins*, 1995 OK CIV APP 42, 893 P.2d 1019.

[215] *Cory v. City of Norman*, 1988 OK CIV APP 7, 757 P.2d 851.

[216] *See* Conclusions of Law 17-20.

[217] Protestants' Response to Division's Application for Hearing En Banc at 1.

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

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

[220] *See Finding of Fact 45*.

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 a store owned by an individual who owned five stores can reasonably be questioned.[221] Although there is no evidence in this case of the size of the store involved, the 2008 NACS Annual Report indicates that the average convenience store is 2,696 square feet.[222] 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.

In this case, because of the due process concerns raised by the conduct of this audit, and based on the specific facts and circumstances of this case, this matter is remanded to the Office of the Administrative Law Judge with directions that the Compliance Division be ordered to revise the assessment of sales taxes against the protestant using the available records of the taxpayer to compute the assessment. Protestant should be afforded the opportunity to respond to such revised assessment.

The Division's request during closing arguments of the hearing on September 20, 2011, for the imposition of a 25% negligence penalty or a 50% fraud penalty are a violation of due process and are denied. [223]

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[221] *See* 2008 NACS Annual Report at 4. *See also* Protestant's Post Hearing Brief at 13.

[222] *See Finding of Fact 69*.

[223] *See Grasso v. Oklahoma Tax Com'n*, 2011 OK CIV APP 37, 249 P.3d 1258.

Attorney Fees may not be awarded in the absence of a statute authorizing such award.[224] There is no statute which would authorize awarding of attorney fees or costs to protestant in this matter. The request of protestants for an award of Attorney Fees and costs 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."

[224] *Burrows Const. Co. v. Independent School Dist. No. 2 of Stephens County*, 1985 OK 57, 704 P.2d 1136.