JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2019-01-17-04 / NON-PRECEDENTIAL**
ID: **P-18-037-K**
DATE: **JANUARY 17, 2019**
DISPOSITION: **DENIED**
TAX TYPE: **SALES / MIXED BEVERAGE**
APPEAL: **NONE**

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, the Commission hereby adopts the Findings of Fact, Conclusions of Law and Recommendation made and entered by the Administrative Law Judge on the 17th day of December, 2018, appended hereto, together herewith shall constitute the Order of the Commission.

SO ORDERED

FINDINGS OF FACT, CONCLUSIONS OF LAW AND RECOMMENDATION

Now on this 17th day of December, 2018, the above styled and numbered cause comes on for decision under assignment regularly made by the Oklahoma Tax Commission to ALJ, Administrative Law Judge. Protestants, COMPANY ("Company"), and MEMBER 1 and MEMBER 2 ("Members") appear pro se. The Compliance Division of the Oklahoma Tax Commission ("Division") is represented by AGC, Assistant General Counsel, Office of General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

Sales and mixed beverage tax audits were conducted by the Division for the period inclusive of the months of September, 2013 through August, 2016 ("Audit Period"), based on information provided by Protestants and Protestants' wholesalers of alcoholic beverages. The audits resulted in the assessments of mixed beverage gross receipts tax and sales tax against the Company, and sales tax against the Members. Protestants timely protested the sales tax assessments. The protest letter was not verified and a hearing was not requested.

On March 8, 2018, the protest and audit records of the Division were referred to the Office of Administrative Law Judges to initiate proceedings under the *Uniform Tax Procedure Code*[1] and the *Rules of Practice and Procedure before the Office of Administrative Law Judges*.[2] The protest was docketed as Case No. P-18-037-K.

A pre-hearing teleconference was scheduled for May 3, 2018.[3] Pursuant to the conference, the parties were directed to file a status report. By *Status Report* filed June 5, 2018, the Division advised that it was awaiting a report from Protestants regarding the status of their amended federal partnership returns of income. Several additional status reports were filed advising the Division was awaiting a response from Protestants.

A status conference was scheduled for September 20, 2018. Protestants did not appear at the conference. By *Status Conference Order* issued September 20, 2018, the Division was directed to file a verified response, Protestants were advised that a reply could be filed, and the parties were notified that if a hearing was not requested, the record would close and the protest submit for decision upon completion of the procedural schedule. Protestants filed no response to this order.

The *Division's Verified Response* ("*Verified Response*") and Exhibits A through E attached thereto were filed as directed. Protestants filed no reply. On November 28, 2018, the record closed and the protest submitted for decision.[4]

The record was reopened by *Order Reopening Record* issued December 7, 2018. On December 12, 2018, the *Compliance Division's Report* ("*Report*") was filed in response to the *Order Reopening Record*. Protestants filed no response to the order. On December 17, 2018, the record was re-closed.

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1 68 O.S. 2011, § 201 et seq., as amended.

2 Rules 710:1-5-20 through 710:1-5-49 of the *Oklahoma Administrative Code* ("*OAC*").

3 *OAC* 710:1-5-28(a).

4 68 O.S. 2011, § 221(D) and *OAC* 710:1-5-39(a).

FINDINGS OF FACT

Upon review of the file and records, including the *Verified Response*, attached Exhibits and the *Report*, the undersigned finds:

A. STATEMENT OF THE FACTS, *Verified Response* provides:[5]

> 1. On or about August 30, 2016, a notice of audit letter was sent to [the Company] advising that it had been selected for an audit.
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> 2. During the audit process, Protestant was asked to complete several informational forms regarding the audit, including a statute of limitations waiver, members list, price list, brand classification, pour statement, and inventory agreement. These documents were completed by Protestant and returned to the auditor.
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> 3. A depletion audit was conducted by the Division using the information provided by Protestant in the audit forms compared to reported sales.
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> 4. During the audit period, Protestant underreported sales tax during the regular course of business. A review of the records provided by Protestant compared against sales tax returns filed with the Commission revealed underreported sales. Also, additional sales tax due was assessed on the amount of underreported mixed beverage sales from the audit.
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> 5. The underreported gross sales and additional mixed beverage sales resulted in a finding by the auditor of additional taxable sales in the amount of $623,556.51. Additional sales tax due was assessed on that amount and resulted in a sales tax assessment in the amount of $52,222.85.
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> 6. On or about February 16, 2017, an assessment letter was sent to Protestant notifying them [sic] that additional sales tax was being assessed as a result of the audit of their records.
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> 7. On or about April 16, 2017, Protestant timely protested the sales tax assessment.
>
> 8. This matter is properly before the Court

B. ADDITIONAL FINDINGS OF FACT:

1. The Company operates a full service restaurant and bar seven days a week in the Midtown area of Oklahoma City. *Field Audit Write Up* ("*Write Up*"), pp. 2, (official notice)[6].

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[5] The references to the Exhibits supporting the statements are omitted.

[6] *OAC* 710:1-5-36(a).

2. The Company was selected for audit due to a low mixed beverage tax ratio (purchases to reported sales) of 0.293. *Write Up, Id.*

3. Protestants serve a nice variety of imported and domestic beers, a large variety of wines by the glass and bottle and various alcoholic drinks. *Write Up*, pp. 3.

4. The records provided to the auditor included: statute of limitation waiver agreements, inventory agreement, price list, pour statement, brand classification, wine list prices, price coding corrections, U.S. Partnership Income Tax Returns for 2013, 2014 and 2015, and drink recipes. *Id*.

5. The depletion audit was completed on Protestants' purchases of alcoholic beverages during the Audit Period since the beginning and ending inventories were unknown. *Write Up*, pp. 4.

6. Certain flavored liqueurs, wines and beers were exempted as mixers and bottles of Corbett Canyon Pinot and Grand Marnier used in cooking were credited as an ending inventory. *Write Up*, pp. 3-4.

7. The pour rates and prices as provided by Protestants, adjusted to exclude mixed beverage gross receipt and sales taxes included in those prices were utilized for the depletion audit. *Id*.; Exhibit B to *Verified Response*.

8. The audit determined that Protestants had unreported mixed beverage sales for the audit period of $12,625.69. Exhibit B to *Verified Response*.

9. The sales tax audit was conducted by comparing Protestants' gross sales as reported on the U.S. Partnership Income Tax Returns with the gross receipts reported by Protestants to the Commission on their sales tax reports. The difference in those amounts; plus the unreported mixed beverage sales, less employee tips were picked up as underreported taxable sales. *Write Up*, pp. 5; Exhibits B and C to *Verified Response*.

10. In performing the sales tax audit, the auditor only looked at Protestants' sales during calendar years 2014 and 2015, and spread the differences in the amounts reported over the 36 month audit period. *Id*.

11. Additional sales tax was assessed against the Company and the Members in the total aggregate amount of $74,781.58, comprising tax of $52,222.85, interest accrued through March 31, 2017, of $17,336.41, and a 30 day delinquent penalty of $5,222.32.[7] Exhibit D to *Verified Response*.

12. *The Taxpayer's List of Principal Officers, Partners or Members (LLC)* reports the Members have been members of the Company from 2007 to present. *See*, note 7.

ISSUE AND CONTENTIONS

The issue presented for decision is whether Protestants have shown that the sales tax audit and assessments are in any respect erroneous.

Protestants contend the sales tax assessment should be revised because employee tips and a loan of $53,500.00 were erroneously accounted for in their records as gross sales for income tax purposes. Protestants allege that the credit for employee tips for 2014 should be $297,593.27 rather than $183,949.00 and that credit card tips of $80,582.72 should be removed from gross sales. For 2015, Protestants allege that the credit for employee tips should be $290,016.03 as opposed to $196,071.00 and that credit card tips of $63,504.38 should be removed from the gross sales figure. In support of their allegations, Protestants submitted copies of the Accounts Receivable Purchase Agreement from GBR Funding and credit card merchant batch tip recaps for 2014 and 2015.

The Division contends that Protestants have merely stated the tips and loan were misreported, but have offered no evidence to show the sales tax assessment is inaccurate or to refute the audit results. The Division argues that credit was given for the amount of tips reported

[7] The sales tax assessments against the two Members are included in the records received from the Division to which official notice is taken. Note 6.

on Form 8846 to the 2014 and 2015 partnership returns of the Company and those returns have not been amended.

CONCLUSIONS OF LAW

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

I. JURISDICTION AND BURDEN OF PROOF

1. Jurisdiction of the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. 2011, § 221(D).

2. The taxpayer has the burden of proof to show the action or proposed action of the Oklahoma Tax Commission is incorrect, and in what respect. *OAC* 710:1-5-47. ***In re Adway Properties, Inc.***, 2006 OK CIV APP 14, 130 P.3d 302; ***Geoffrey, Inc. v. Oklahoma Tax Commission***, 2006 OK CIV APP 27, 132 P.3d 632. If the taxpayer fails to prove a prima facie case, the protest may be denied solely on the grounds of failure to prove sufficient facts which would entitle the taxpayer to the requested relief. *OAC* 710:1-5-47; ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 1988 OK 91, 768 P.2d 359, 362, citing *Continental Oil Co. v. Oklahoma State Bd. of Equalization*, 1976 OK 23, 570 P.2d 315, 317.

3. The burden of proof standard is "preponderance of evidence." 2 Am.Jur.2d *Administrative Law* § 357. "Preponderance of evidence" means "[e]vidence which is of greater weight or more convincing than the evidence offered in opposition to it; that is, evidence which as a whole shows the fact sought to be proved is more probable than not * * * evidence which is more credible and convincing to the mind * * * that which best accords with reason and probability." BLACK'S LAW DICTIONARY 1064 (5th ed. 1979). Each element of the claim must be supported by reliable, probative, and substantial evidence of sufficient quality and quantity as to show the existence of the facts supporting the claim are more probable than their nonexistence. 2 Am.Jur.2d *Administrative Law* § 357.

4. An order of the Tax Commission must be supported by substantial evidence. ***Dugger v. State ex rel. Oklahoma Tax Commission***, 1992 OK 105, 834 P.2d 964. Likewise, the

audit upon which a portion of the record is formed and order issued, must be supported by substantial evidence. Oklahoma Tax Commission Order No. 2003-07-22-09, 2003 WL 2347117.

5. An audit is supported by substantial evidence when an evidentiary foundation for the audit has been established. Usually the evidentiary foundation will be established by the records reviewed by the auditor. Where an evidentiary foundation has been established, the taxpayer must prove the action of the Tax Commission in assessing the tax is incorrect, and in what respect. *OAC* 710:1-5-47; ***Enterprise Management Consultants, Inc.,*** supra. However, where an evidentiary foundation has not been laid or the records upon which the audit is based establish no basis for assessing a tax, the audit and assessment in the initial instance cannot be sustained as supported by substantial evidence. ***Dugger***, supra.

II. ADMINISTRATIVE RULES AND REGULATIONS

1. Rules promulgated under the Administrative Procedures Act[8] are presumed to be valid until declared otherwise by a court of competent jurisdiction. 75 O.S. 2011, § 306(C). They are valid and binding on the persons they affect, have the force of law and are prima facie evidence of the proper interpretation of the matter to which they refer. 75 O.S. 2011, § 308.2(C).

2. The rules and regulations of an administrative agency which implement a statute are valid unless they are beyond the scope of the statute, conflict with the statute or are unreasonable. See, ***Arkansas Louisiana Gas Co. v. Travis***, 1984 OK 33, 682 P.2d 225; ***Boydston v. State***, 1954 OK 327, 277 P.2d 138. Agency rules need not be specifically authorized by statute, but must generally reflect the intent of the Legislature as expressed in the statute. ***Jarboe Sales Company v. Oklahoma Alcoholic Beverage Laws Enforcement Commission***, 2003 OK CIV APP 23, 65 P.3d 289. As a general rule, it is presumed that administrative rules and regulations are fair and reasonable, and the complaining party must prove the contrary by competent and convincing evidence. ***State ex rel. Hart v. Parham***, 1966 OK 9, 412 P.2d 142.

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[8] 75 O.S. 2011, § 250 et seq., § 301 et seq.

3. Great weight is accorded an agency's construction of a statute when the administrative interpretation is made contemporaneously with the enactment of the statute and the construction is longstanding and continuous by the agency charge with its execution. ***Schulte Oil Co., Inc. v. Oklahoma Tax Commission***, 1994 OK 103, 882 P.2d 65. Where the Legislature is made repeatedly aware of the operation of the statute according to the construction placed upon it by an agency and the Legislature has not expressed its disapproval with the agency's construction, the Legislature's silence may be regarded as acquiescence in the agency's construction, ***R.R. Tway, Inc. v. Oklahoma Tax Commission***, 1995 OK 129, 910 P.2d 972; and the agency's construction is given controlling weight and will not be disregarded except in cases of serious doubt, ***Cox v. Dawson***, 1996 OK 11, 911 P.2d 272.

III. SALES TAX

1. The collection, reporting and remittance of sales taxes are governed by the Oklahoma Sales Tax Code ("Code").[9] An excise tax is levied upon the gross receipts or gross proceeds of all sales, not otherwise exempted by the Code. 68 O.S. 2011, § 1354(A).

2. The sale[10] of "[f]ood, confections, and all drinks sold or dispensed by hotels, restaurants, or other dispensers, and sold for immediate consumption upon the premises or delivered or carried away from the premises for consumption elsewhere" is expressly made subject to sales taxes. 68 O.S. 2011, § 1354(A)(10).

3. The total gross receipts subject to sales tax from the sale of mixed beverages is the "total of the retail sale price received for the sale, preparation or service of mixed beverages, ice, and nonalcoholic beverages to be mixed with alcoholic beverages". 37 O.S. Supp. 2014, § 576(E). *See*, *OAC* 710:65-19-5(a) which provides:

> Persons selling alcoholic beverages to purchasers for use or consumption are required to remit sales tax to the Commission upon the total retail value from such sales, pursuant to *OAC*

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[9] 68 O.S. 2011, § 1350 et seq., as amended.

[10] Defined to mean "the transfer of either title or possession of tangible personal property for a valuable consideration regardless of the manner, method, instrumentality, or device by which the transfer is accomplished in this state". 68 O.S. 2011, § 1352(22).

> 710:20-5-4, notwithstanding the fact that manufacturers and importing distributors of alcoholic beverages are required to pay certain taxes.

4. It is presumed for purposes of the proper administration of the Code that "all gross receipts are subject to tax until they are shown to be tax exempt", *OAC* 710:65-1-4(A); and all sales of tangible personal property are subject to tax until the contrary is established, *OAC* 710:65-3-30(b). The burden of proving a sale is not a taxable sale is on the person who made the sale. 68 O.S. 2011, § 1365(F).

IV. MEMBER LIABILITY FOR SALES TAX

1. The tax levied by the Code is paid by the consumer or user to the vendor as trustee for and on account of this state and every vendor must collect from the consumer or user the full amount of the tax or an amount equal nearly as possible or practicable to the average equivalent thereof. 68 O.S. Supp. 2014, § 1361(A).

2. Every person required to collect any tax imposed by the Code is personally liable for the tax. *Id*. "Any sum or sums collected or accrued or required to be collected or accrued under the Code shall be deemed to be held in trust for the State of Oklahoma, and, as trustee, the collecting vendor * * * shall have a fiduciary duty to the State of Oklahoma in regards to such sums and shall be subject to the trust laws of this state." 68 O.S. Supp. 2014, § 1361(F).

3. Included in the definition of "Vendor" is "any person making sales of tangible personal property or services in this state, the gross receipt or gross proceeds from which are taxed by the * * * Code[.]" 68 O.S. 2011, § 1352(28)(a). A "person" under the Code includes "any individual, company, partnership, joint venture, joint agreement, association, mutual or otherwise, limited liability company, corporation". 68 O.S. 2011, § 1352(18).

4. When a proposed assessment is filed against a corporation, limited liability company or other legal entity for unpaid sales taxes, a proposed assessment must be filed against the individuals personally liable for the tax. 68 O.S. Supp. 2014, § 253(A). An individual is personally liable for the tax if, during the time for which the assessment was made, the individual was responsible for collection and remittance of taxes or had direct control, supervision or

responsibility for filing returns and paying the tax due. 68 O.S. Supp. 2014, § 253(B). Personal liability is determined under the Internal Revenue Code standards for determining liability for the payment of federal withholding tax. 68 O.S. Supp. 2014, § 253(C).

ANALYSIS

The sales tax audit was conducted utilizing a standardized formula of comparing reported gross sales (income tax vis-a-vis sales tax) and picking up the difference; plus the unreported mixed beverage sales, less employee tips as underreported taxable sales. Protestants have not shown the credit card tips and loan were included in the gross sales reported for income tax purposes or that employee tips were understated for income tax purposes.

RECOMMENDATIONS

The protest should be denied. The amount assessed, inclusive of any additional accrued and accruing interest should be respectively fixed jointly and severally as the deficiencies due and owing by Protestants.

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 2014) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002).