

Cite as Det No. 11-0346, 32 WTD 60 (2013)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of) D E T E R M I N A T I O N
Assessment of)
) No. 11-0346
...)
) Registration No.
) Document No. /Audit No.
)
) Docket No.

RULE 244, RULE 254; RCW 82.32.070;; RETAIL SALES TAX – RETAILING B&O TAX – RECORDKEEPING – FAILURE TO KEEP RECORDS. All sales of food and food ingredients at an establishment will be treated as taxable unless the seller separately accounts for sales of exempt and nonexempt food and food ingredients. Rule 244(6). The Department is authorized to estimate a grocery store owner's retail sales tax liability where the taxpayer failed to keep or provide reliable and complete records detailing taxable and nontaxable sales.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Eckholm, A.L.J. – A taxpayer doing business as a convenience store protests an audit assessment of retail sales tax asserting that Audit underestimated the amount of tax-exempt food sales made during the audit period. We affirm the assessment.¹

ISSUE

In the absence of Taxpayer records, was the methodology used by Audit in estimating Taxpayer's sales of exempt food and nonexempt items consistent with the requirements of RCW 82.32.070 and WAC 458-20-254?

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDINGS OF FACT

The taxpayer operates a convenience store and sells both retail sales taxable and retail sales tax exempt items, including: food, soft drinks, wine, beer, tobacco, personal health supplies, phone cards, tobacco products and similar items commonly found at such stores. The Department of Revenue (Department) through its Audit Division (Audit,) examined the Taxpayer's books and records for the period March 1, 2006, through December 31, 2009. Due to the lack of sales records, Audit estimated sales subject to retail sales tax based on a sample of the purchase records listed on the Cost of Goods Sold report provided by the taxpayer. The auditor and the taxpayer's representative agreed to a sample of the period 2008 to verify the taxability of the taxpayer's purchases for resale.

The auditor reviewed the purchase lists with the taxpayer's representative and compared the invoice totals with the percentage amounts assigned to both taxable and nontaxable amounts. . . . The dollar amount of the exempt food total was stated as a percentage relationship to the dollar amount of the sampled items and this percentage was then applied to the gross sales reported to arrive at those amounts qualified as exempt food sales. The sample analysis showed that the rate of exempt food was 63 percent. The auditor compared the 63 percent figure with amounts actually deducted on the taxpayer's excise tax returns for the sale of tax exempt food products. The auditor then assessed retail sales tax on the difference between the amounts deducted and 63 percent figure. The auditor concluded that the primary reason for the disallowed deductions was the taxpayer's failure to charge sales tax on the sale of phone cards and other taxable purchases.

On December 1, 2010, the Department issued Document No. . . ., a tax assessment for \$ The assessment consisted of retail sales tax of \$, retailing business and occupation tax of \$, deferred sales tax/use tax of \$, and interest of \$ The taxpayer appealed the assessment claiming that the auditor included some tax-exempt food purchases in the sample population resulting in a lower percentage of tax exempt food items during the sampled period.

ANALYSIS

The sales of non-exempt items at a convenience store are subject to retail sales tax. RCW 82.08.020. RCW 82.08.0293 provides a retail sales tax exemption for certain sales of food and food ingredients, as follows:

- (1) The tax levied by RCW 82.08.020 [does] not apply to sales of food and food ingredients. "Food and food ingredients" means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value

RCW 82.08.0293(1). The Department promulgated WAC 458-20-244 (Rule 244) to implement RCW 82.08.0293 and states, in pertinent part:

(6) **What are the seller's accounting requirements?** All sales of food and food ingredients at an establishment will be treated as taxable unless the seller separately accounts for sales of exempt and nonexempt food and food ingredients. It is sufficient separation for accounting purposes if cash registers or the like are programmed to identify items that are not tax exempt and to calculate and assess the proper sales tax accordingly.

Rule 244(6).

The taxpayer did not provide adequate sales records to verify the sales of exempt food and the deductions on the taxpayer's excise tax returns. The taxpayer has not fulfilled its accounting requirements under Rule 244(6).

In addition to Rule 244, RCW 82.32.070 requires taxpayers in this state to maintain records adequate for the Department of Revenue to determine the tax liability of such taxpayer. RCW 82.32.070(1) states:

Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue. . . . Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

WAC 458-20-254 (Rule 254) sets forth specific requirements for a taxpayer to maintain and disclose books, records, and other sources of financial information to the DOR. Rule 254 states, in relevant part:

(3) Recordkeeping requirements – General.

(a) Every taxpayer liable for a tax or fee imposed by the laws of the state of Washington for which the department of revenue has primary or secondary administrative responsibility... must keep complete and adequate records from which the department may determine any tax liability for such taxpayer.

(b) It is the duty of each taxpayer to prepare and preserve all records in a systematic manner conforming to accepted accounting methods and procedures. Such records are to be kept, preserved, and presented upon request of the department or its authorized representatives which will demonstrate:

(i) The amounts of gross receipts and sales from all sources, however derived, including barter or exchange transactions, whether or not such receipts or sales are

taxable. These amounts must be supported by original source documents or records including but not limited to all purchase invoices, sales invoices, contracts, and such other records as may be necessary to substantiate gross receipts and sales.

(ii) The amounts of all deductions, exemptions, or credits claimed through supporting records or documentation required by statute or administrative rule, or other supporting records or documentation necessary to substantiate the deduction, exemption, or credit.

...

(c) The records kept, preserved, and presented must include the normal records maintained by an ordinary prudent business person. Such records may include general ledgers, sales journals, cash receipts journals, bank statements, check registers, and purchase journals, together with all bills, invoices, cash register tapes, and other records or documents of original entry supporting the books of account entries. The records must include all federal and state tax returns and reports and all schedules, work papers, instructions, and other data used in the preparation of the tax reports or returns.

In the present case, the taxpayer did not keep complete normal records maintained by an ordinary prudent business person. The taxpayer failed to keep complete sales records detailing taxable and nontaxable sales. If taxpayers fail to maintain and provide adequate records, the Department is authorized to estimate their state excise tax liability. In this regard, RCW 82.32.100 states:

(1) If any person fails or refuses to make any return or to make available for examination the records required by this chapter, the department shall proceed, in such manner as it may deem best, to obtain facts and information on which to base its estimate of the tax; and to this end the department may examine the records of any such person as provided in RCW 82.32.110.

(2) As soon as the department procures such facts and information as it is able to obtain upon which to base the assessment of any tax payable by any person who has failed or refused to make a return, it shall proceed to determine and assess against such person the tax and any applicable penalties or interest due, but such action shall not deprive such person from appealing the assessment as provided in this chapter.

Here, due to the lack of sales records, the purchase records listed on the taxpayer's Cost of Goods Sold report were the only records available to assist in determining taxable and nontaxable items. Audit estimated sales subject to retail sales tax based on a sample period agreed to by the taxpayer. The auditor reviewed the purchase lists with the taxpayer's representative and negotiated with the taxpayer's representative the taxability of the vendors where purchase invoices for the period were missing. The sample analysis showed that the rate of exempt food was 63 percent. In a time-period sample the reasonable assumption is that the activities during the sample period are representative of the actual operations of the grocery store for the entire audit period. We addressed audit sampling and use of a test period in Det. No. 99-341, 20 WTD 343 (2001). That case also involved a small grocery or convenience store that sold

tax-exempt groceries as well as taxable food and non-food products. We concluded that the use of purchases to calculate the percentage of taxable sales, and the audit technique of using samples and projecting them over a test period has long been considered acceptable. *See also* Det. No. 04-0084, 24 WTD 365 (2005).

In the case at hand we affirm the use of inventory purchases to project taxable sales. The sample period and purchase records were agreed to by the taxpayer. Nothing has been presented that persuades us that Audit's methodology was unreasonable or was not an accepted method for estimating tax due when complete records are not available. Pursuant to RCW 82.32.070 the Audit Division's estimate was reasonable under the circumstances of this case. . . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 6th day of December, 2011.