

REDACTED DECISIONS – DOCKET NOS. 11-240 CU, 11-241 NFN, 11-242 C

**BY: A. M. “FENWAY” POLLACK, CHIEF ADMINISTRATIVE LAW JUDGE
SUBMITTED FOR DECISION ON MAY 31, 2012
DECISION ISSUED ON JANUARY 29, 2013**

SYNOPSIS

TAXATION -- PROCEDURE AND ADMINISTRATION -- It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).

TAXATION -- PROCEDURE AND ADMINISTRATION -- “The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable.” W. Va. Code Ann. § 11-10-11(a) (West 2010).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- Article Fifteen of the West Virginia Tax Code imposes a general consumers sales and service tax, for the privilege of selling tangible personal property or custom software and for the privilege of furnishing certain selected services, and it is the duty of the vendor to collect the same. *See* W. Va. Code Ann. § 11-15-1 and § 11-15-3 (West 2010).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- “The purchaser shall pay to the vendor the amount of tax levied by this article which shall be added to and constitute a part of the sales price, and shall be collectible as such by the vendor who shall account to the State for all tax paid by the purchaser.” W. Va. Code Ann. § 11-15-4 (West 2010).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- “(b) The vendor shall keep records necessary to account for: (1) The vendor's gross proceeds from sales of personal property and services; (2) The vendor's gross proceeds from taxable sales; (3) The vendor's gross proceeds from exempt sales; (4) The amount of taxes collected under this article, which taxes shall be held in trust for the state of West Virginia until paid over to the Tax Commissioner” W. Va. Code Ann. § 11-15-4 (West 2010).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- “To prevent evasion, it is presumed that all sales and services are subject to the tax until the contrary is clearly established.” W. Va. Code Ann. § 11-15-6(b) (West 2010).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- “Every person doing business in the State of West Virginia...shall keep complete and accurate records as are necessary for the Tax Commissioner to determine the liability of each vendor or vendee for consumer sales and use tax purposes.” W. Va. Code R. § 110-15-14a.1 (1993).

TAXATION -- CONSUMERS SALES AND SERVICE TAX -- If, when auditing taxpayer records, said records are, “. . . inadequate to accurately reflect the business operations of the taxpayer, the tax auditor will determine the best information available and will base the audit report on that information.” W. Va. Code R. § 110-15-14b.4 (1993).

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- The Petitioner failed to account for and remit to the Tax Commissioner all of the sales taxes collected from its customers.

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- The records which were provided to the Tax Commissioner were not complete and accurate enough to determine the Petitioner’s liability for consumers sales and use tax purposes. Nor were they adequate to accurately reflect the Petitioner’s business operations.

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- The Tax Commissioner did not abuse his discretion in conducting a survey of the Petitioner’s operations from its parking lot. However, by the way he weighted these customer counts the Tax Commissioner did not use the best information available to ascertain how many customers the restaurant served per day.

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- Approximately 8.5 percent of the customers served each day at the Petitioner’s restaurant were children.

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- The Tax Commissioner did not use the best information available to ascertain how much each customer spent. This deficiency was cured by the Tax Commissioner’s agreement to stipulate to Petitioner’s Exhibit 3 concerning the Petitioner’s historical menu prices and prices for children’s meals.

TAXATION -- PROCEDURE AND ADMINISTRATION -- “If the Tax Commissioner believes that any tax administered under this article has been insufficiently returned by a taxpayer, either because the taxpayer has failed to properly remit the tax, or has failed to make a return, or has made a return which is incomplete, deficient or otherwise erroneous, he may proceed to investigate and determine or estimate the tax liability and make an assessment therefor.” W. Va. Code Ann. § 11-10-7(a) (West 2010).

WEST VIRGINIA OFFICE OF TAX APPEALS -- BURDEN OF PROOF -- In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010); W. Va. Code R. §§ 121-1-63.1 and 69.2 (2003).

WEST VIRGINIA OFFICE OF TAX APPEALS -- BURDEN OF PROOF NOT MET-- The Tax Commissioner’s assessment against the Petitioner for underreported corporate net income was not erroneous, unlawful, void or otherwise invalid.

WEST VIRGINIA OFFICE OF TAX APPEALS -- BURDEN OF PROOF MET-- The Petitioner in this matter has met its burden of showing that the sales tax and combined sales and use tax assessments against it were erroneous as discussed above.

FINAL DECISION

On May 26, 2011, the Auditing Division of the West Virginia State Tax Commissioner's Office (the Tax Department or the Respondent) issued three Audit Notice of Assessments, against the Petitioner, (hereinafter the Petitioner). These assessments were issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 10 *et seq.*, of the West Virginia Code. The first assessment was for sales tax for the period of January 1, 2008, through June 30, 2008, for tax in the amount of \$____, interest in the amount of \$____, and additions to tax in the amount of \$____, for a total assessed tax liability of \$____. The second assessment was for combined sales and use tax for the period September 1, 2008, through March 31, 2011, for tax in the amount of \$____, interest in the amount of \$____ and additions to tax in the amount of \$____, for a total assessed liability of \$____. The third assessment was for corporate income and franchise tax for the period September 1, 2007 to August 31, 2010, for tax in the amount of \$____, interest in the amount of \$____ and additions to tax in the amount of \$____, for a total assessed liability of \$____. Written notice of these assessments was served on the Petitioner as required by law.

Thereafter, on July 11, 2011, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, three petitions for reassessment. *See* W. Va. Code Ann. §§ 11-10A-8(1); 11-10A-9 (West 2010).

Subsequently, notice of a hearing on the petitions was sent to the Petitioner, and a hearing was held in accordance with the provisions of West Virginia Code Section 11-10A-10.

FINDINGS OF FACT

1. The Petitioner owns and operates a restaurant in a West Virginia city, in a West Virginia county.
2. In December of 2010, auditors from the West Virginia State Tax Department traveled to the offices of the Petitioner's accountant for the purpose of conducting an audit of the Petitioner's business.
3. During this December 2010 visit, the auditors were provided with some financial records, such as bank statements, purchase invoices, tax returns and guest checks from July 2010 to September 2010. The auditors were not provided with any cash register tapes.
4. At the conclusion of their visit, the auditors requested guest checks for the period November 2010 through January 2011.
5. The Petitioner's accountant sent the requested guest checks to the auditors by mail.
6. The auditors found all of the guest checks they were provided to be inadequate to accurately reflect the Petitioner's business operations. The auditors made this determination because the guest checks were new, unwrinkled, in pristine condition, fresh smelling, and many of them did not have dates. The lack of dates made it impossible for the auditors to compare the checks to the daily summaries provided by the accountant.
7. Meanwhile, the Tax Commissioner undertook surveillance of the Petitioner's establishment on two days in November 2010. On both days, two Tax Department employees sat outside the restaurant from opening until approximately 10 p.m. During that time they noted the number of people that entered and the time of entry.

8. In February of 2011, the auditors received the guest checks they had requested from the Petitioner's accountant. These guest checks were also in pristine condition with no wrinkles or odors. Additionally, they did not match the monthly sales summaries that had been provided by the accountant. As a result, the auditors were of the opinion that the books and records of the Petitioner were inadequate to accurately reflect its business operations.

9. To complete the audit, the auditors were forced to rely upon the surveillance to ascertain the average number of customers the restaurant served each day. The auditors counted two hundred and nineteen (219) people entering on a Tuesday and three hundred and seven (307) entering on a Friday.¹ They added those two numbers and divided by seven to arrive at an average daily customer count of two hundred and sixty-three (263) people. They then took that number and multiplied it by the average check amount for each customer. They arrived at the average check amount by adding the three different buffet prices² and dividing by three. The average check amount that the auditors arrived at was \$____. The next calculation involved the number of customers who ordered soft drinks, which based upon representations from the accountant, the auditors calculated at 60 percent. Then the auditors multiplied the information they had gathered to arrive at a calculated amount of daily, monthly and yearly sales. The auditors then took these extrapolated sales amounts and calculated the Petitioner's unremitted sales taxes and issued the assessments in the amounts listed above. Finally, they calculated the Petitioner's underreported corporate net income, based upon the restaurant's additional attributed sales.

10. In calculating, the Petitioner's additional corporate net income the auditor's attempted to take into account the Petitioner's additional expenses, such as additional food costs.

¹ Part of the observers' calculation included noting those customers who had take-out orders. The observers counted each take out bag as one order.

² Monday through Friday lunch, (\$_) Monday through Friday dinner (\$_) and all day Saturday and Sunday (\$_).

However, the auditors were informed by the accountant that much of the Petitioner's food was purchased for cash, and as such, additional receipts could not be provided.

11. At the evidentiary hearing in this matter, the Petitioner introduced Exhibit 3, which contained both the historical buffet prices for the period of the audit and the children's menu prices. During the hearing, Tax Commissioner's counsel stipulated to the accuracy of Exhibit 3, thereby acknowledging that the Petitioner's prices had risen during the audit period, and that the Petitioner had different menu prices for children.

DISCUSSION

The West Virginia Code provides that “[f]or the privilege of selling tangible personal property and of dispensing certain select services . . . the vendor shall collect from the purchaser the tax as provided under this article, and shall pay the amount of tax to the Commissioner in accordance with the provisions of this article.” W. Va. Code Ann. § 11-15-3(a) (West 2010). A vendor is defined as “any person engaged in this state in furnishing services taxed by this article or making sales of tangible personal property.” W. Va. Code Ann. § 11-15-2(z) (West 2010).

Likewise, the Code provides that “The purchaser shall pay to the vendor the amount of tax levied by this article which shall be added to and constitute a part of the sales price, and shall be collectible as such by the vendor who shall account to the State for all tax paid by the purchaser.” W. Va. Code Ann. § 11-15-4 (West 2010). Section 4 also lays out the record keeping requirements for vendors tasked with collecting sales tax.

(b) The vendor shall keep records necessary to account for: (1) The vendor's gross proceeds from sales of personal property and services; (2) The vendor's gross proceeds from taxable sales; (3) The vendor's gross proceeds from exempt sales; (4) The amount of taxes collected under this article, which taxes shall be held in trust for the state of West Virginia until paid over to the tax commissioner

Id.

Section 14a of Title 110, Series 15 of the West Virginia Code of State Rules also lays out the record keeping requirements of business people in the state, “Every person doing business in the State of West Virginia . . . shall keep complete and accurate records as are necessary for the Tax Commissioner to determine the liability of each vendor or vendee for consumers sales and use tax purposes.” W. Va. Code R. § 110-15-14a.1 (1993). Further, “if records are inadequate to accurately reflect the business operations of the taxpayer the tax auditor will determine the best information available and will base the audit report on that information.” W. Va. Code R. § 110-14b.4 (1993).

Finally,

If the Tax Commissioner believes that any tax administered under this article has been insufficiently returned by a taxpayer, either because the taxpayer has failed to properly remit the tax, or has failed to make a return, or has made a return which is incomplete, deficient or otherwise erroneous, he may proceed to investigate and determine or estimate the tax liability and make an assessment therefor.

W. Va. Code Ann. § 11-10-7(a) (West 2010).

Here, the Tax Commissioner attempted to audit the Petitioner’s books and discovered that it had not kept adequate records to account for its proceeds from the sales of personal property, namely food and drink in its restaurant. The Tax Commissioner discovered that the Petitioner’s records were not at all adequate to accurately reflect the Petitioner’s business operations. As a result, the Tax Commissioner undertook an investigation and issued assessments for what he believed was underreported sales in the restaurant and unremitted sales tax that had been collected from the restaurant’s customers. It is clear from the testimony and evidence in this matter that the Petitioner was underreporting its food and drink sales and that its records were not adequate to accurately reflect its business operations. Therefore, the only

question for this Tribunal is, did the Tax Commissioner use the best information available in preparing the audit report?

The respective positions of the parties can be summed up by two exhibits. State's Exhibit 2 shows the mathematical calculations used by the auditors. Petitioner's Exhibit 8 shows the calculations it believes the Tax Commissioner should have used. Given that during the evidentiary hearing the parties were able to agree on Petitioner's Exhibit 3, much of the dispute between the parties goes away. The parties agree on the average menu price during the audit period. The parties also agree that there was a different menu price for children. The parties do not agree on the amount of customers served by the restaurant each day. The Petitioner argues that the Tax Commissioner gave too much weight to the Friday count of 307 customers. A brief description of what each party did in calculating the average daily customer count is helpful. The Tax Commissioner took the Tuesday number and the Friday number and weighed each at 50 percent. The Petitioner took the lower Tuesday number and weighted it at approximately 86% and took the Friday number and weighted it at the remaining 14 percent. Additionally, the Petitioner adjusted the Tuesday and Friday numbers to reflect what it called errors in the observers' counts.

At the outset, this Tribunal acknowledges that due to the inadequate record keeping of the Petitioner, the Tax Commissioner was correct in conducting a survey of the Petitioner's business from the parking lot. We also find the Petitioner's arguments regarding "errors" in the observers' customer count to be unpersuasive. The Petitioner has not provided this Tribunal with better information regarding how many customers it serves each day. It is the Petitioner's failure to maintain adequate records that forced the Tax Commissioner to send observers to sit outside the restaurant for two whole days. That being said, we do rule that by giving equal

weight to the Tuesday and Friday counts, the Tax Commissioner has not used the best information available to ascertain how many customers the restaurant serves each day.

This Tribunal is not bound by the West Virginia Rules of Evidence. Rather, it may “admit and give probative effect to evidence of a type commonly relied upon by a reasonably prudent person in the conduct of his or her affairs.” W. Va. Code Ann. § 11-10A-10(c) (West 2010). The undersigned takes that cited language as a directive from the Legislature to use common sense in deciding how much probative effect to give to any piece of evidence or particular testimony. Here, common sense dictates that the 307 customers served on the Friday do not merit the 50 percent weight given to them by the Tax Department auditors. Common sense and years of eating in restaurants tells us that the weekends are busier than weekdays. Therefore, the Tuesday count should represent an average weekday, (Monday through Thursday) or 57 percent of the weekly count. Friday’s count would represent the average weekend, (Friday, Saturday and Sunday) or 43 percent of the weekly count. It should be noted that one of the Tax Commissioner’s witnesses acknowledged that this method of weighting would probably give a more accurate daily customer count.

Due to the fact that the parties agree on the menu prices, thereby making the average check calculation easy, and due to our ruling on the amount of customers served each day, the only remaining calculation is how many of the daily customers were children. The Petitioner argues that 10 percent of the restaurant’s customers were children; however, it presented no evidence to back up that figure. While State’s Exhibit 2 does not account for children, fortunately the observers’ handwritten notes (State’s Exhibit 1) do note the number of children entering the restaurant. These notes show twenty-two (22) children, entering on Tuesday and twenty-three (23) on Friday. This means children accounted for 10 percent of Tuesday’s

customers and 7 percent of Friday's customers, or approximately 8.5 percent of each day's total customers.

Our final area of discussion concerns the Tax Commissioner's assessment for the Petitioner's underreported corporate net income. West Virginia Code Section 11-10-7(a) allows the Tax Commissioner to investigate and determine taxpayer's unpaid liabilities. That is precisely what he has done here. As part of his investigation he discovered that the Petitioner was underreporting its sales of food and drink. Those sales logically created increased income to the corporation; income that was not reported on the Petitioner's federal or state income tax returns. As a result, the Tax Commissioner adjusted the Petitioner's corporate net income accordingly. At hearing, the Petitioner half-heartedly argued that the auditors did not give the Petitioner credit for the additional expenses that would come from these attributed increased sales. The Petitioner particularly argued that the auditors should have given it credit for the extra food expenses that would logically have come from these increased customer counts. The problem with the Petitioner's argument in this regard is that it was unable to provide either the auditors or this Tribunal with evidence of these increased expenses. As stated above, the Petitioner's accountant told the auditors that much of the food was purchased with cash, and as such there were no additional invoices to provide. Additionally, at hearing, the Petitioner's representative prepared an exhibit which purported to show a 45 percent increase in the cost of goods sold (Petitioner's Ex. 12). However, she then testified that she had brought no evidence regarding additional food expenses.

JUDGE POLLACK: Okay. And lastly, let me ask you a question about Exhibit 12.

PETITIONER'S WITNESS: Uh-huh (yes). Exhibit 12, yes.

JUDGE POLLACK: Have you brought ---? Have you provided to Mr. Mudrinich ---

PETITIONER'S WITNESS: Uh-huh (yes).

JUDGE POLLACK: --- anything to show cost of goods sold at 45 percent or operating expenses at 30 percent?

PETITIONER'S WITNESS: Corporate tax returns for three years, the period from '08, '09, '10, was provided to the auditor.

JUDGE POLLACK: I mean, additional cost of goods sold or operating expenses in line with the increased sales.

PETITIONER'S WITNESS: Additional?

JUDGE POLLACK: Yeah.

PETITIONER'S WITNESS: No.

See Transcript pg. 109. Of course, the Petitioner's inability to provide any additional invoices or other documents is indicative of the Catch-22 it finds itself caught in. It wants to lower its tax burden related to this audit, but to do so it must show that it purchased more food than reported on its Federal Schedule C. Doing so then proves that it underreported its actual sales.

CONCLUSIONS OF LAW

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).

2. "The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable." W. Va. Code Ann. § 11-10-11(a) (West 2010).

3. Article Fifteen of the West Virginia Tax Code imposes a general consumer's sales and service tax, for the privilege of selling tangible personal property or custom software and for the privilege of furnishing certain selected services, and it is the duty of the vendor to collect the same. *See* W. Va. Code Ann. § 11-15-1 and § 11-15-3 (West 2010).

4. "The purchaser shall pay to the vendor the amount of tax levied by this article which shall be added to and constitute a part of the sales price, and shall be collectible as such by the vendor who shall account to the State for all tax paid by the purchaser." W. Va. Code Ann. § 11-15-4 (West 2010).

5. “(b) The vendor shall keep records necessary to account for: (1) The vendor's gross proceeds from sales of personal property and services; (2) The vendor's gross proceeds from taxable sales; (3) The vendor's gross proceeds from exempt sales; (4) The amount of taxes collected under this article, which taxes shall be held in trust for the state of West Virginia until paid over to the tax commissioner” W. Va. Code Ann. § 11-15-4 (West 2010).

6. “To prevent evasion, it is presumed that all sales and services are subject to the tax until the contrary is clearly established.” W. Va. Code Ann. § 11-15-6(b) (West 2010).

7. “Every person doing business in the State of West Virginia...shall keep complete and accurate records as are necessary for the Tax Commissioner to determine the liability of each vendor or vendee for consumer sales and use tax purposes.” W. Va. Code R. § 110-15-14a.1 (1993).

8. If, when auditing taxpayer records, said records are, “. . . inadequate to accurately reflect the business operations of the taxpayer, the tax auditor will determine the best information available and will base the audit report on that information.” W. Va. Code R. § 110-15-14b.4 (1993).

9. The Petitioner failed to account for and remit to the Tax Commissioner all of the sales taxes collected from its customers.

10. The records which were provided to the Tax Commissioner were not complete and accurate enough to determine the Petitioner’s liability for consumer sales and use tax purposes. Nor were they adequate to accurately reflect the Petitioner’s business operations.

11. The Tax Commissioner did not abuse his discretion in conducting a survey of the Petitioner’s operations from its parking lot. However, by the way he weighted these customer

counts the Tax Commissioner did not use the best information available to ascertain how many customers the restaurant served per day.

12. Approximately 8.5 percent of the customers served each day at the Petitioner's restaurant were children.

13. The Tax Commissioner did not use the best information available to ascertain how much each customer spent. This deficiency was cured by the Tax Commissioner's agreement to stipulate to Petitioner's Exhibit 3 concerning the Petitioner's historical menu prices and prices for children's meals.

14. "If the Tax Commissioner believes that any tax administered under this article has been insufficiently returned by a taxpayer, either because the taxpayer has failed to properly remit the tax, or has failed to make a return, or has made a return which is incomplete, deficient or otherwise erroneous, he may proceed to investigate and determine or estimate the tax liability and make an assessment therefor." W. Va. Code Ann. § 11-10-7(a) (West 2010).

15. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010); W. Va. Code. R. §§ 121-1-63.1 and 69.2 (2003).

16. The Tax Commissioner's assessment against the Petitioner for underreported corporate net income was not erroneous, unlawful, void or otherwise invalid.

17. The Petitioner in this matter has met its burden of showing that the sales tax and combined sales and use tax assessments against it were erroneous as discussed above.

FINAL DECISION

Based upon the above, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the three assessments issued against the Petitioner on May 26, 2011, are hereby **MODIFIED** in a manner consistent with this decision and now reflect, as of³ December 15, 2012, the amounts due as follows:

1) The sales tax assessment for the period of January 1, 2008, through June 30, 2008, for tax of \$____, interest of \$____ and additions to tax of \$____,for a total liability of \$_____.

2) The combined sales and use tax assessment for the period September 1, 2008 through March 31, 2011 for tax of \$____, interest of \$____ and additions to tax of \$____ for a total liability of \$_____.

3) The corporate income and franchise tax assessment for the period September 1, 2007 to August 31, 2010 for tax of \$____, interest of \$____ and additions to tax of \$____ for a total liability of \$_____.

These three modified assessments reflect a total liability due of \$_____.

Interest continues to accrue on this unpaid tax until this liability is fully paid. W. Va. Code Ann. § 11-10-17(a) 2010).

WEST VIRGINIA OFFICE OF TAX APPEALS

By: _____
A. M. "Fenway" Pollack
Chief Administrative Law Judge

Date Entered

³ The recalculated amounts in this matter came to the Office of Tax Appeals on two different dates. Therefore, the "as of" date for corporate net income/business franchise tax assessment is January 31, 2013.