Cite as Det. No. 95-138, 16 WTD 33 (1995)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition For Correction of Assessment | ) | D E T E R M I N A T I O N |
| | ) | No. 95-138 |
| . . . | ) | Registration No. . . . |
| | ) | FY. . ./Audit No. . . . |

EXCISE TAX BULLETIN 101.04.107: BEST INDICATION OF SALES. Cash register reading raises a presumption that sales were made in the amount recorded. The best evidence of the minimum gross proceeds of sales is the cash register reading.

1 RCW 82.32.070: TEST PERIODS. RCW 82.32.070 requires the taxpayer to keep and preserve suitable records so that its tax liability may be correctly determined. Failure to comply with this requirement forever bars the taxpayer from questioning the correctness of any assessment of taxes based upon the period for which the records have not been suitably kept.

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.

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NATURE OF ACTION:

Taxpayer protests the assessment of retailing business and occupation (B&O) tax and retail sales tax on unreported restaurant income developed from the projection of an error rate found in review of a mutually agreed upon sample.[1]

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

## FACTS:

Lewis, A.L.J. -- Taxpayer operates a eat-in/take-out restaurant in Washington. Her business records were audited by the Department of Revenue (Department) for the period January 1, 1990 through September 30, 1993. On July 1, 1994, an audit assessment was issued for tax and interest. Taxpayer filed an appeal requesting a correction of the tax contained in audit schedule II that recorded retailing B&O tax and retail sales tax on unreported restaurant income.

Taxpayer used a cash register to record her sales. Twice a day Taxpayer totaled the sales recorded by the cash register. The sales totals were printed on a cash register tape commonly referred to as a "Z" tape. Taxpayer reported income to the Department on a cash basis using a "Z" tape total as the measure of cash received.

The Department's Audit Division verified the accuracy of Taxpayer's income reporting procedure by comparing the total income recorded on the cash register to the income reported to the Department. Consistent with the Audit Division's audit policy, selected periods were examined to verify the accuracy of income reported. With the agreement of Taxpayer, the Department's Audit Division examined the "Z" tapes, summaries of sales recorded on the cash register, for October 1993, February 1990, April 1990, and September 1990. Income shown on the "Z" tapes was compared to that reported to the Department. The comparison of "Z" tape totals to income reported to the Department revealed under-reported income. The Department determined that the under-reporting occurred because Taxpayer only reported the first (interim) "Z" tape total and not the final "Z" tape total that represented the total income for the day. The audit adjustment was developed by projecting the error rate found in the sample period to all periods of the audit. The Department states that the only months that complete records were available were those tested.

## ISSUES:

(1) Whether the best indication of sales is cash register totals or deposits to bank accounts when the two amounts differ?

(2) Whether Taxpayer must accept an audit adjustment, based on a projection of the error rate found in a sample, when Taxpayer has failed to maintain detailed records to support the amount she has reported?

## DISCUSSION:

Taxpayer objects to the Department's reliance on the results of the sample and its calculation of the tax adjustment based on a projection of the sample's results.

Taxpayer objects to the Department's reliance on the "Z" tape totals as the best measure of income. She maintains that the "Z" tape totals are inaccurate because they contain uncorrected overrings, and that uncorrected "Z" tape totals contain errors in "keying in" sales transactions and overstate income. Taxpayer contends that the better measure of income is cash deposited. Taxpayer has provided a schedule of money deposited in her personal and business bank accounts.

The combined amount of the accounts, although more than the amount reported to the Department, is significantly less than the amount projected by the Department. Additionally, Taxpayer maintains that it would be impossible for a restaurant of its size to achieve the level of sales projected by the Department. Taxpayer has provided a schedule of sales made at "comparable" restaurants. The "comparable" restaurants all have lower sales than that projected for Taxpayer by the Department. Taxpayer contends that the Department's projection of sales is unreasonable because the level of sales at "comparable" restaurants is lower than that projected by the Department.

WAC 458-20-119 (Rule 119) is the administrative provision that discusses the tax treatment of income derived from the sale of meals. It provides:

> All persons making sales of meals, upon which the retail sales applies under the provisions set forth in this ruling, are required to pay the business and occupation tax under the retailing classification upon the <u>gross proceeds</u> derived from such sales.
>
> RESTAURANTS AND OTHER EATING PLACES. Sales of meals by hotels, restaurants, cafeterias, clubs, boarding houses and other eating places are subject to the retail sales tax.

(Emphasis added.)

Thus, the gross proceeds derived from the sale of meals and beverages by a restaurant are subject to the retailing B&O tax and retail sales tax.

RCW 82.04.070 defines "GROSS PROCEEDS OF SALES" as:

> "Gross proceeds of sales" means the value proceeding or accruing from the sale of tangible personal property and/or for services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

[1] ETB 101.04.107, 1 ETB 139 (ETB 101) explains the Department's position on the effect of cash shortages and/or overages on the measure of tax liability. The ETB states:

> Many businesses reporting on a cash basis use the sales as recorded within the cash registers to determine the gross sales. On occasion, these businesses find that they have a cash shortage and/or overage when reconciling their actual cash on hand with the cash registers.
>
> The business and occupation and retail sales taxes are imposed on the gross proceeds of sales, or selling price. These terms are defined very broadly by statute, with no allowance for the deduction of costs or expenses incurred by the seller.
>
> The Department has uniformly held that cash shortages generally may not be deducted from the gross proceeds of sales. <u>The cash register reading raises the presumption that sales were made in the amounts recorded</u>. While part of the shortage could represent uncorrected "over-rings," other factors may be the cause of the apparent discrepancy. For example, the taxpayer may have made payments in cash to a supplier or carrier and failed to record the "cash paid-out." <u>Unless the business can show that the cash shortage is the result of an error in recording sales, the best evidence of the minimum gross proceeds of sales is deemed to be the cash register reading</u>.

(Emphasis added.)

Taxpayer's contentions are unpersuasive in light of the ETB. The ETB makes clear that the amount of money deposited in a bank account may be less than the amount received from sales for a variety of reasons, including unrecorded cash paid outs. Second, the ETB makes clear that even though uncorrected overrings may cause a discrepancy, "the best evidence of the <u>minimum</u> gross proceeds of sales is deemed to be the cash register reading."

Determination No. 89-493, 8 WTD 309 (1989) affirmed the ETB pronouncement by stating:

> The issue is whether or not the taxpayer received the amounts shown on the cash register tapes even though the money was not in the till at the end of the day when they were compared. The tape creates a presumption that the cash was received and then somehow lost. Based on RCW 82.08.080 and ETB 101.08.107, no deduction or offset is allowed unless the taxpayer can show the error was due to record keeping errors such as uncorrected ringups rather than pilferage from dishonest employees or some other cause as suggested in the ETB.

Taxpayer maintained that the projected income figures were unreasonable. In support of this position she presented sales figures from other "similar" restaurants. The income figures for these similar restaurants more closely approximated the sales reported by Taxpayer than those estimated by the Department. We find this information unpersuasive. The sales developed by any business is dependent on many factors, such as location, size of facility, decor, menu, quality of food, advertising, and price. We cannot conclude Taxpayer's sales were overestimated because the level of sales at other restaurants approximates the sales reported by Taxpayer.

Thus, we find that the Department's reliance on results of the sampling of "Z" tapes was appropriate.

[2] Taxpayer not only objects to the Department's reliance on the results of the sample, but also to the calculation of the tax adjustment based on a projection of the sample's results.

RCW 82.32.070 provides:

> 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 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 <u>shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes</u> made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

(Emphasis added.)

Determination No. 90-216, 9 WTD 292-9 (1990) states the Department's position regarding reliance on tax adjustments based on projections of the results of samples when actual detail records were unavailable:

> The above statute requires the taxpayer to keep and preserve suitable records so that its tax liability may be correctly determined. Where the taxpayer has failed to fulfill that duty, thus necessitating a projection based upon the records now available, we will not favorably entertain an argument that the test period is unrepresentative. Should the taxpayer subsequently, locate its records, it may present them to the audit section for the appropriate examination. Accordingly, we must deny the taxpayer's petition on this issue.

Taxpayer is required to retain "suitable records as may be necessary to determine the amount of any tax for which he may be liable." The tax adjustment was calculated using the records mutually agreed upon by the Department and Taxpayer. The Department states that the only months that complete records were available were those tested.

The use of test periods and projections is a commonly used and widely accepted auditing technique. We find that the cash register "Z" tape totals are the best indication of the level of Taxpayer's sales. We find that a projection rate based on a representative sample is acceptable. Accordingly, we affirm the retailing B&O and retail sales taxes assessed on unreported restaurant sales based on the projection of an error rate found in a sample.

DECISION:

Taxpayer's petition is denied.

DATED this 25th day of July, 1995.