Cite as Det. No. 17-0155, 36 WTD 613 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	
	)	No. 17-0155
	)	
. . .	)	Registration No. . . .
	)	

RCW 82.32.100; WAC 458-20-254: RETAIL SALES TAX AND RETAILING B&O TAX – REASONABLE ESTIMATES – RECORDKEEPING. When a taxpayer does not maintain complete records to substantiate its cash sales, the Department's estimated cash sales percentage is not an abuse of discretion when a sampling of the taxpayer's records indicates a cash sales percentage that is nearly identical to the Department's estimated cash sales percentage.

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.

Sattelberg, T.R.O. (successor to Bauer T.R.O.) – A restaurant ("Taxpayer") protests the Department of Revenue's ("Department") assessment of retail sales tax and business and occupation ("B&O") tax under the retailing classification. Taxpayer argues the Department erroneously estimated cash sales. We deny the petition.[1]

ISSUE

Is Taxpayer liable for estimated retail sales tax and retailing B&O tax under RCW 82.32.100, when it did not maintain complete records under RCW 82.32.070 and WAC 458-20-254 ("Rule 254"), to substantiate its cash sales, and when some of the records provided support the estimated cash sales percentage used by the Department?

FINDINGS OF FACT

Taxpayer is a fast food restaurant in . . . , Washington. Taxpayer opened its tax reporting account with the Department as of November 8, 2010. Taxpayer consistently reported its income under the retailing B&O tax classification with retail sales tax collected and remitted since its inception.

In 2015, the Department's Audit Division ("Audit") began auditing Taxpayer's records for the time period January 1, 2011, through December 31, 2014. Taxpayer stated that it did not have register tapes ("Z-tapes") or sales reports. Taxpayer provided its bank statements, federal income

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

tax returns, and profit and loss statements to Audit for the audit period. Audit found that the bank statements showed cash deposits as a percentage of gross sales as follows:

2011	21%
2012	20%
2013	8%
2014	4%

Audit compared these percentages to the percentage of cash sales in the fast food industry from a 2008 study by First Data Corporation, as well as to internal Departmental statistical data. Audit found that Taxpayer's cash sales percentages were so comparatively low that they must be artificially low, as both sets of data showed a cash sales percentage for fast food restaurants over 50 percent. Since Taxpayer had not provided complete records of sales transactions, and since the records provided indicated an artificially low cash sales percentage, Audit estimated cash sales. Audit concluded a reasonable estimate of cash sales was 60 percent of total sales based on the First Data study and internal data. Audit then applied its 60 percent estimate by dividing Taxpayer's gross sales by 40 percent, after removing cash deposits from the bank statement records Taxpayer had provided.[2] Taxpayer did not agree with this methodology, and at their March 2015 supervisor's conference, it requested more time to gather additional records, which Audit granted.

On March 25, 2015, Taxpayer provided Audit with partial records for 2014 and 2015. Audit analyzed the 2014 records, which covered January through October. Audit found that the percentage of cash sales during this period was 56 percent.[3] Audit analyzed the 2015 records, which covered March 31 through April 14. Audit found that the percentage of cash sales during this period was 57 percent.[4] Audit found that there were multiple missing records for both time periods. Taxpayer disagreed with Audit's conclusions about the percentage of cash sales. The

[2] Audit did not give the federal income tax returns or the profit and loss statements any weight.

[3] Audit compared sales from the register, the cash and check sales, against the sales from merchant closing statements, the credit and debit card sales, for each month from January through September of 2014. The analysis found the following monthly percentages of cash sales and merchant sales:

	Register	Merchant
January	55%	45%
February	57%	43%
March	58%	42%
April	56%	44%
May	57%	43%
June	57%	43%
July	52%	48%
August	52%	48%
September	56%	44%

Audit's analysis did not indicate final percentages for October.

[4] Audit did not analyze records provided for March 28 through 30 as they contained significant errors. Audit also notes several flaws in the 2015 sample, including multiple "no sales" and voids within two weeks, check sales were twice cash sales, multiple missing Z-tapes, and multiple duplicate merchant receipts.

parties were not able to agree on an alternative methodology regarding cash sales. On May 6, 2015, Audit issued Taxpayer an assessment totaling $. . . .[5]

In June of 2015, Taxpayer hired its second representative, who told Audit there were newly discovered Z-tapes that it would provide Audit. Audit agreed to place the assessment on hold while it awaited the new documentation. Audit reviewed what the second representative provided and found the newly-supplied documents to not be the Z-tapes as promised. Audit did not give these records any weight due to their incompleteness. Audit left the assessment on hold.

In December of 2015, the second representative provided Audit with a 2010 Hitachi Consulting report that showed that fast food restaurants' cash sales percentage averaged 55 percent. Audit reviewed the study and agreed to adjust the estimated cash sales percentage to 55 percent since Taxpayer had not otherwise provided complete records and 55 percent was close to the 56 percent cash sales from the 2014 records, and close to the 57 percent cash sales from the 2015 records.

Taxpayer hired its third representative in February of 2016. The third representative provided Audit handwritten journals it claimed accurately represented its sales during the audit period. Audit reviewed the handwritten journals and did not regard them as suitable documentation of sales transactions since they were provided so long after the audit had commenced.

Taxpayer and Audit met to discuss the audit again on March 14, 2016. The parties discussed the records that were provided and why Audit determined they were insufficient, as well as Audit's decision to reduce the estimated cash sales percentage to 55 percent. The third representative acknowledged that Taxpayer had underreported cash sales, but claimed that the correct cash sales percentage should be 36 percent based on 2011 and 2012 point of sales records. Audit countered that the 2011 and 2012 point of sales records were incomplete.[6] The third representative requested more time to produce additional records, which Audit granted. Audit requested sample records for January 1 through 5, 2013, January 1 through 5, 2014, and June 1 through 5, 2014. Taxpayer provided the requested records, but Audit determined they were not persuasive as a basis from which to estimate cash sales.

The parties were again unable to agree on an alternative methodology. Audit issued Taxpayer a post-assessment adjustment using the lower 55 percent cash sales estimate on June 17, 2016, totaling $ . . . .[7]

Taxpayer timely petitioned for review of the assessment contesting Audit's estimated cash sales of 55 percent. Taxpayer's first argument on review is that Audit's estimated cash sales percentage cannot be correct because it results in food cost percentages and labor cost percentages that are well outside industry norms. To support this argument, Taxpayer provided a summary of its food costs and labor costs for the audit period. Taxpayer supported its total food costs figures with a

[5] The assessment consisted of $ . . . in retail sales tax, $ . . . in retailing B&O tax, a $ . . . substantial underpayment penalty, and $ . . . in interest.

[6] Audit states the 2011 and 2012 point of sales records were incomplete because there were multiple daily control records missing. Audit states the Taxpayer closed its point of sales system an average of three times per day in the beginning of 2011. This dropped to two times in mid-2011

[7] The post-assessment adjustment consisted of $ . . . in retail sales tax, $ . . . in retailing B&O tax, a $ . . . substantial underpayment penalty, and $ . . . in interest.

yearly total of charges from . . . , a food supplier. Taxpayer supported its total labor costs figures with a printout showing total wages by employee per year. Taxpayer states that if Audit's estimated cash sales percentage is correct then it results in a food cost percentage of approximately 14 percent, and a labor cost percentage of approximately 6 percent. Taxpayer provided articles discussing restaurant industry standards for food costs and labor costs percentages.[8] According to the articles, both food costs and labor costs typically range from 25 percent to 35 percent of total sales. Taxpayer argues Audit's food cost of 14 percent and labor cost of 6 percent make its estimated cash sales percentage unreasonable as they are so far below the 25 percent to 35 percent industry standard ranges for both measures.

Next, Taxpayer provided spreadsheets with summaries of its sales for the audit period on review. These spreadsheets indicate the following cash sales percentages:

2011	32%
2012	29%
2013	20%
2014	23%

Taxpayer provided spreadsheets for each year of the audit period, with each year broken down by month. The spreadsheets start with total sales from each of the three shifts; morning, afternoon, and night; to arrive at total sales for the day. Then cash sales figures for each shift are given to arrive at total cash sales for the day. Finally, credit sales are calculated by subtracting total cash sales from total daily sales. Taxpayer did not provide documentation to support the cash sales and total sales data in the spreadsheets, nor did Taxpayer provide documentation to show that credit sales reconcile to its formula of total sales minus cash sales.

Finally, on October 6, 2016, Taxpayer delivered numerous records while on review. Taxpayer described the records submitted as Z-tapes for all of 2011; January through October of 2012; October, November, and December of 2013; all of 2014; and September of 2016. Taxpayer claimed these records supported a cash sales percentage from between 23 and 30 percent. Audit reviewed the records submitted and determined that they were records that they had previously reviewed, and did not change its estimated cash sales percentage of 55 percent.

ANALYSIS

Washington imposes retail sales tax and retailing B&O tax on each retail sale in this state. RCW 82.08.020; RCW 82.04.250. Sales of meals and prepared foods to consumers by restaurants are subject to the retailing tax classification and generally subject to retail sales tax. WAC 458-20-124(2).

Every taxpayer is required to "keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of tax for which he may be liable . . . ." RCW 82.32.070. *See also* RCW 82.32A.030 (taxpayers must "[k]eep accurate and complete business records").

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[8] Steven Buckley, *Common Food & Labor Cost Percentages*, Chron (2017), . . . ; Ron Gorodesky and Kate Lange, *Restaurant Accounting: For Profit's Sake, Inventory Your Food Cost!*, Restaurant Report (2017), . . . ; Restaurant Benchmarks, Baker Tilly (2014), ...

Rule 254 sets forth specific requirements for a taxpayer to maintain and disclose books, records, and other sources of financial information to the Department. Rule 254 states the following:

> (3) Recordkeeping requirements – General.
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> (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. The 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.
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> . . .
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> (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.

In the event a person fails to keep and preserve suitable records, then "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. . . ."[9] RCW 82.32.100(1). We have previously affirmed the Department's authority to assess taxes based on a reasonable estimate. *See, e.g.* Det. No. 15-0350, 35 WTD 291 (2016). In order for a taxpayer to successfully challenge an estimated assessment, the taxpayer must show that the Department abused its discretion in formulating the estimate. Det. No. 13-0302R, 33 WTD 572 (2014) An abuse of discretion occurs when a decision rests on untenable grounds or is manifestly unreasonable. *Mayer v. Sto Indus., Inc.*, 156 Wn.2d 677, 684, 132 P.3d 115 (2006); Kreidler v. Cascade Nat'l. Ins. Co., 179 Wn. App. 851, 861, 321 P.3d 281 (2014).

Here, Taxpayer did not maintain complete business records and so Audit estimated its cash sales percentage based on an industry report Taxpayer provided and on some of the records Taxpayer provided. Taxpayer's sole point of dispute after Audit adjusted the assessment is that it believes Audit's estimated cash sales of 55 percent is too high. Taxpayer admits that it underreported cash sales during the audit period. Taxpayer also admits that it did not maintain sufficient records to accurately establish its actual cash sales through the audit period. Taxpayer provided Audit numerous samples of documents throughout the audit in an effort to establish a cash sales estimate based on records, but Audit rejected most of these samples due to their incompleteness. The two sets of records that Audit considered the most complete indicated that Taxpayer had a cash sales of 56 percent from the 2014 records and 57 percent from the 2015 records.

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[9] A Department auditor is particularly qualified by training and experience to determine which records are suitable for determining the amount of tax due. Det. No. 14-0170, 34 WTD 030 (2015).

We conclude Audit correctly determined that the business records Taxpayer supplied indicated an underreporting of cash sales, which allowed Audit to exercise its broad discretion under RCW 82.32.100 to estimate cash sales. We find no evidence that Audit abused its discretion in determining the need to estimate cash sales or that it acted unreasonably in generating that estimate. Since Taxpayer provided records that support Audit's estimated cash sales percentage of 55 percent, we conclude this estimate was reasonable.

Taxpayer argues that if Audit's estimated cash sales percentage is correct, it results in a food cost of 14 percent and a labor cost of 6 percent, both of which are well below industry standards of 25 percent to 35 percent for both measures. However, Taxpayer has admitted that it underreported cash sales. Based on the admission that cash sales were underreported, we cannot agree with Taxpayer that food cost and labor cost percentages are enough of an indicator to conclude that Audit abused its discretion in its estimate of cash sales.

As for Taxpayer's spreadsheets that Taxpayer submitted on review that indicate cash sales percentages between 20 and 32 percent for the audit period, these figures are not supported by complete records. Without full documentation to support them, we cannot consider them to conclude that Audit abused its discretion in its estimated cash sales percentage.

Finally, Audit has reviewed other additional documentation submitted on review and concluded it is insufficient to support adjustment to the already-adjusted assessment. We have not seen any evidence that makes us question Audit's thoroughness in this case. Accordingly, we deny the Taxpayer's petition.

DECISION AND DISPOSITION

We deny Taxpayer's petition.

Dated this 21st day of June 2017.