Cite as Det No. 12-0201, 32 WTD 151 (2013)

BEFORE THE APPEALS 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. 12-0201
. . .	)	
	)	Registration No. . . .
	)	Document No. . . . /Audit No. . . .
	)	
	)	Docket No. . . .
	)	

RULE 254; RCW 82.32.070: RECORDS – SUBSTANTIATION – CASH SALES. Rule 254(3) requires taxpayers to prepare and preserve original source documents or such other records as may be necessary to substantiate gross receipts and sales. Where Taxpayer provided only handwritten daily sales journals to support its claimed amount of cash sales, an examination of sales invoices revealed Taxpayer paid cash for various items for the business, and Taxpayer's infrequent cash deposits could not be reconciled with the claimed cash sales listed in the handwritten daily sales journals, Audit properly used an industry average for cash sales to estimate and assess retailing business and occupation tax and retail sales tax.

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.

Anderson, A.L.J. – An owner of a restaurant that failed to maintain source records protests Audit's use of an industry average percentage to determine cash sales and the assessment of retail sales tax. It contends its records and facts and circumstances reasonably prove its cash sales were less than the industry average percentage. We conclude the Taxpayer failed to maintain adequate records of cash sales, Audit's use of an industry average percentage was correct, and deny the petition.[1]

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

ISSUE

Are the Taxpayer's records sufficient under RCW 82.32.070 to prove its cash sales were less than industry average?

FINDINGS OF FACT

Taxpayer . . . operates a restaurant in . . . Washington. Taxpayer sells food, beverages, and liquor to retail customers.

Audit examined Taxpayer's books and records for the period of January 1, 2007 through December 31, 2010 ("Audit Period"). Taxpayer provided daily sales journals, daily credit batch totals [for credit cards], purchase receipts, Federal income tax returns, and bank statements. The daily sales journals summarized daily sales amounts and were handwritten. Taxpayer did not produce any cash register tapes/Z tapes ("Z tapes") or source documents to verify the amounts in the daily sales journals.

To verify that Taxpayer had correctly reported and paid retail sales tax and retailing business and occupation ("B&O") tax, Audit reconciled amounts in business records with amounts reported to the Department. Audit determined that it was not possible to verify cash sales income because Taxpayer was missing source documents, such as cash register tapes (Z-tapes) and a complete set of guest checks, to corroborate amounts entered in handwritten daily sales journals.

During the Audit Period, cash deposits were infrequent. Audit was unable to reconcile cash bank deposits and purchase receipts where Taxpayer paid in cash, with amounts reported to the Department. It found that this discrepancy indicated that cash from the register was used regularly to purchase various items for business and not reported to the Department. It conducted an analysis of the percentage of income received in cash (compared to credit card sales), calculated unreported cash sales, and assessed retailing B&O tax and retail sales tax on unreported cash sales.

During the Audit Period, Taxpayer reported approximately 20 percent cash sales, and the industry average for cash sales in sit-down restaurants was 30 percent.[2] Because Taxpayer was missing source documents, Audit increased cash sales to 30 percent of the total sales[3] in the income reconciliation and assessed retailing B&O ($. . .) and retail sales tax ($. . .) on the unreported cash sales. On July 18, 2011, Audit issued Document Number . . . for $. . ., assessing $. . . in retail sales tax, $. . . in retailing B&O tax, $. . . in use tax/deferred retail sales tax, and $. . . in interest.

Taxpayer appealed the entire assessment. However, it did not present argument or address the assessment of use tax/deferred retail sales tax in its Appeal Petition, during the hearing, or in any

[2] This is based on a survey conducted by First Data.
[3] Total sales were adjusted to account for Taxpayer's mistaken inclusion of tip income in credit card payments.

subsequent correspondence or contact. Therefore, we need only address its appeal of the assessment of retail sales tax, retailing B&O tax, and interest.

Taxpayer argues that the methodology used to conduct the audit was fundamentally flawed. It argues the use of the industry average for cash sales was flawed, as there were records outside the Audit Period that consistently showed cash sales were historically 20%. In support of this assertion, Taxpayer provided a spreadsheet detailing calculations of the cash sales percentage for each year during the Audit Period; the calculations are based upon numbers from Taxpayer's handwritten daily sales journal.

Taxpayer asserts that it followed the record keeping procedures per the Revised Code of Washington and submitted monthly sales journals, general ledgers, sales recapture worksheets, bank statements, and Federal income tax returns. Taxpayer asserts these records were rejected by the Department and it insisted on relying solely on the Z-tapes. Taxpayer states that it lost the Z-tapes during multiple moves of its owner's personal residence. When asked about Z-tapes outside of the Audit Period, Taxpayer reported that these Z-tapes were also lost in the moves.

In addition, Taxpayer argues the infrequent monthly cash deposits support its assertion that 20% of total sales were cash sales, because there was less cash to deposit. It states that Audit failed to explain why the 30% industry average is applicable to it other than "because it is an industry average."

ANALYSIS

Every person liable for tax "shall 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. It is the responsibility of the Taxpayer to keep accurate and complete business records. RCW 82.32A.030.

As relevant here, 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 Department. Rule 254 states, in relevant part:

> (3) Recordkeeping requirements – General.
>
> > (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 amount of gross receipts and sales from all sources, however derived, including barter or exchange transactions, whether or not such receipts or sales are taxable. <u>These amounts must be supported by original source documents or records including but not limited to all purchase</u>

> invoices, sales invoices, contracts, and such other records as may be necessary to substantiate gross receipts and sales. (Emphasis added.) . . .

> (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. (Emphasis added.)

In the present case, Taxpayer did not keep or disclose records to substantiate the amount of gross receipts and cash sales during the Audit Period. Rule 254 requires original source documents or records to substantiate gross receipts and sales. Taxpayer provided only handwritten daily sales journals to support its claimed amount of gross receipts and cash sales during the Audit Period. There were no source documents, such as Z-tapes, provided to verify the amounts of gross receipts and cash sales reported, as required by Rule 254. *See also* Det. No. 89-53, 7 WTD 137 (1989) (Handwritten records in a spiral notebook on which a month and sometimes a year are written at the top are patently unacceptable as true and accurate daily records of the restaurant's operations. There is no way whatever of telling when each sheet was provided, proof of date of preparation, identity of the person making the entry, or evidence proving that the number written on each line reflects sales . . .").

Further, bank statements showed Taxpayer made infrequent cash deposits during the Audit Period. And, an examination of sales invoices revealed that the Taxpayer paid cash for various items for the business during the Audit Period. Because Taxpayer's bank statements were not a reliable reflection of gross receipts and cash sales, Audit used statistical data to estimate cash income and gross receipts for the Audit Period.

If a taxpayer fails to maintain and provide adequate records, the Department is authorized to estimate their state excise tax liability. RCW 82.32.100; WAC 458-20-254; Det. No. 99-341, 20 WTD 343 (2001) ("A taxpayer who fails to keep suitable records may not successfully complain about an ensuing tax assessment."). Based on Taxpayer's failure to maintain adequate records of its gross receipts and cash sales during the Audit Period, we find no error in Audit's choice of using an industry standard to determine gross receipts and cash sales, and assess retailing B&O tax and retail sales tax. . . .

In sum, we deny Taxpayer's claims that Audit erred in estimating the measure of gross receipts and cash sales, and tax in its assessment. Taxpayer's petition is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 9th day of August, 2012.