STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH
MICHIGAN TAX TRIBUNAL

Babel Enterprises, Inc.,
Petitioner,
v
MTT Docket No. 321051

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Cynthia J Knoll

FINAL OPINION AND JUDGMENT

## SUMMARY

Petitioner, Babel Enterprises, Inc., appeals an assessment issued by Respondent, Michigan Department of Treasury, of sales tax plus interest and penalties. The assessment is the result of an audit conducted during which Respondent found Petitioner's records to be insufficient and its deduction for non-taxable food to be excessive. Petitioner disagrees with Respondent's assumptions and calculations, contending that Respondent's determination of unpaid tax is incorrect. Because Petitioner failed to maintain adequate records of its business, the Tribunal finds that Respondent was authorized to determine and assess the tax based on the best available information. However, Petitioner met its burden of proof regarding certain corrections to the audit conclusion.

## BACKGROUND

Petitioner owns and operates a retail grocery/party store located in Saginaw, Michigan. Respondent conducted a sales tax audit for the tax period beginning October 1, 2001, through February 28, 2005. Respondent's auditor determined a deficiency based upon an inaccurate deduction for food for human/home consumption, which is tax exempt. The auditor found that the appropriate food deduction was 41.96%, whereas the deduction taken by Petitioner ranged from 69% to 90% for each period under audit. Respondent issued its Intent to Assess and imposed a 10% negligence penalty because of Petitioner's failure to maintain proper records. On February 20, 2006, Respondent issued Final Bill for Taxes Due (Final Assessment) No. N638376 for $38,446.00 tax, $3,845.00 penalty, and $5,583.89 interest and Petitioner timely filed an appeal with the Tribunal.

## PETITIONER'S CONTENTIONS

Petitioner contests the liability for tax, penalties, and interest assessed by Respondent, claiming it "reported to the best of [its] knowledge all sales and, therefore, should not be liable for the additional tax as established by the State of Michigan."[1] Petitioner claims the "improper

[1] Petitioner's Petition

computation by the Revenue Agent distorted the true findings and caused a substantial increase in the sales taxes which was improper."[2]

On February 8, 2006, Petitioner submitted a letter to the Michigan Department of Treasury, Collection Division, with a copy to the Tribunal, stating that the proposed balance due for unreported sales tax "is incorrect as follows:

1. For [October] 1, 2001 through December 31, 2001, taxpayer reported $249,509.00 as gross income, and stated that $161,320.00 was for non-taxable items. The Agent permitted only $75,580.00 and disallowed $85,740.00.
2. For January 1, 2002 to December 31, 2002, taxpayer reported $925,846.00 for total sales. The amount reported for food for the period, January 1, 2002 to December 31, 2002 was $474,124.00, and the Agent disallowed $199,680.00 stating it was for taxable items, and this is incorrect. The figure of $474,124.00 is correct. The entire proposed tax, penalty and interest for that year is incorrect.
3. For the year January 1, 2003 to December 31, 2003, taxpayer reported $835,327.00 as sales, of which he claimed $366,786.00 was for food and non-taxable items. The Agent disallowed $129,750.00, saying it was for taxable sales. This figure is also incorrect.
4. From January 2, 2004 to December 31, 2004, taxpayer reported $893,080.00 for total sales, of which the Corporation claimed $476,786.00 as non-taxable. The Agent adjusted it and disallowed $231,868.00 of said amount as taxable sales. This is incorrect.
5. For the year January 1, 2005 through December 31, 2005, taxpayer reported $127,229.00 as income, of which $60,820.00 was non-taxable. The Agent disallowed $26,769.00 of this amount as being taxable. Taxpayer states that 60% of the corporation's sales are non-taxable food and candy. Because of the area of the City of Saginaw which is involved, there is a great deal of food sold, including items sold for food stamps and WIC for infants and children. There is also a great deal of cheese, lunch meat, bread, milk, and baby foods sold, and the figures disallowed by the Agent are excessive.
6. Because of the location of the store the amount of theft is extremely high, as pointed out by articles in the Saginaw News. . . . The amount of theft is at least 5%, and the food is marked up in order to cover this aspect. The amount of breakage, particularly alcohol, is substantial and no credit was given for that. In addition to bad checks, there was counterfeit money . . . . and this amounted to approximately $3,000.00 per year.
7. Several employees during this period of time were terminated because of theft or assisting friends and reducing the amounts due from the cash register.
8. There was approximately $30,000.00 of Money Orders stolen. This does not adversely affect the sales tax, but it shows the tendency of theft by employees in this area.
9. In establishing the markup, the Agent claimed the markup for beer and wine is 19.06%. For cigarettes it is 11.19%. The taxpayer claims according to his

[2] Petitioner's Trial Brief (PTB), p. 3

> bookkeeper and the sales, the markup is between 10% and 13%, not figures of 19.06%. The Agent would not accept any arguments. The markup was between 10% and 13%."

Petitioner contends that there are a number of errors and inaccurate assumptions made in Respondent's determination of tax liability. In its Trial Brief, Petitioner contends that "there is a difference in the 'true figures' for taxable and non-taxable items compared to those assessed by the Auditor." (PTB, p. 2) It claims that ". . . testimony of competent witnesses will include actual markup on products . . . ." *Id.* Following are Petitioner's specific contentions:

a. Petitioner asserts that from 2001 to 2004, there was an increase in inventory of over $29,117, and that Respondent "based [its] findings upon the majority which was taxable exclusive of perishable non-taxable food." (PTB, p. 2) Petitioner argues that the increase in inventory was due to an increase in taxable product and that sales must be adjusted downward to reflect the change in inventory levels.
b. Petitioner points out that "the general ledger/financial statement purchases are 20% lower than [the amount reflected] on the corporate tax returns." (PTB, p. 3) Petitioner contends that the additional expenses were for purchases made by check or personal funds which were tallied and added at the end of the year. Petitioner believes that "[i]t is likely these purchases would be for food as there are many more food vendors, rather than beer/wine/cigarettes vendors, to purchase items from." (PTB, p. 3) Petitioner argues that the percentage of non-taxable food must be increased to reflect the year-end adjustment.
c. Petitioner believes that "even though [it has] recalculated to 54.61% . . . non-taxable food sales, the proper percentage should be at least 60% of non-liquor sales being due to the predominant use of WIC/EBT (food stamp)." (PTB, p. 3)
d. Petitioner contends that the sample time periods selected by Respondent's auditor resulted in substantial incorrect total sales tax due. It stated "the auditor selected February thru May of 2004, and multiplied it by the four year period of time which is incorrect because the larger food sales were during the month (sic) of November and December, thru the Thanksgiving and Christmas holidays." (PTB, p. 3)
e. Petitioner asserts that theft is larger than 3%, arguing that it should be a minimum of 5%. It further stated that "[i]n actuality, 5% may even be low, given the economic strife the eastside of Saginaw has endured." (PTB, p. 3)
f. Petitioner believes that there is a difference in the actual markup of beer versus the markup used by the auditor. Petitioner contends that its "markup on beer/wine is not more than 10%. . . . [Because] distributors for beer/wine are a select few in the Saginaw area, the middlemen involved received a good portion of the profit." (PTB, p. 4)

Petitioner "concede[s] the estimated 2004 total sales of non-liquor calculated on behalf of the taxpayer appear to be reasonable." (PTB, p. 4) At hearing, Petitioner submitted evidence and testimony in support of its position that $881.00 of non-taxable purchases were omitted from the sample. It also challenged the average monthly purchases of beer/wine used by Respondent.

Petitioner offered the following evidence:

A. Federal Income Tax returns for 2001, 2002, 2003 and 2004 – No objection, admitted.

B. Recalculation of Auditor's Findings – Respondent made a partial objection specifically as to pages 8 through 22 because the documents appear to be invoices issued to "Webber Foods" and there is no evidence to show that Webber Foods and Babel Enterprises are one and the same entity. Petitioner responded by saying they are not one and the same, but the store is located on Webber Street, previously went by the name "Webber Foods," and vendors continue to use the old name. (Trans. pp. 76 – 78). Objection overruled by the Tribunal because the address on the invoices is that of Petitioner, the dates coincide with the assessments and Petitioner would not otherwise have copies of these documents. Admitted.
C. Affidavit of Abir L Slioah (Assistant Manager) as to the markup on beer, the percentage of non-taxable food versus taxable products sold, and the annual percentage of loss due to breakage and theft – Respondent made an objection because the witness, Ms. Slioah, testified that she did not prepare nor does she remember preparing the affidavit or assembling any of the information contained in it. (Trans. pp. 24 – 26) Objection sustained, not admitted.
D. Summary of Auditor's Findings – No Objection, admitted.
E. Financial Statements, Compilation without Audit for year ended 12/31/2004 – Respondent made an objection because the accountant who prepared the document was not present at the hearing to verify any of the information. The Tribunal questioned the significant loss reported on the sale of beer and wine, as well as the incomplete balance sheet. The Financial Statement also lacked a signature. Petitioner stated it does not "need the financial statement. The tax return has her signature on it and she prepared it." (Trans. pp. 78 & 79) Objection sustained, not admitted.
F. Curriculum Vitae, Peggy C. Rokita, CPA – Petitioner's expert witness. No objection, admitted.

Finally, Petitioner appeals the 10% negligence penalty. Petitioner's expert witness testified that the daily Z-ring (i.e., cash register) tapes were provided to the third-party accountant and recorded on a computerized spreadsheet for use in preparing the monthly sales tax returns. She stated that the auditor did not review this information despite having been made available to him. Petitioner contends that it acted in good faith by maintaining the required documentation and providing it to the accountant for tax return preparation.

## RESPONDENT'S CONTENTIONS

Respondent contends that Petitioner claimed an excessive deduction for non-taxable food sales in reporting its sales tax returns. Respondent cites Michigan law which places a duty upon every taxpayer to file returns and remit sales taxes as due. Respondent contends that it has statutory authority to collect a tax on sales from all persons engaged in the business of making retail sales and that it may assess taxes against a taxpayer who fails to pay the correct amount of tax. Respondent argues that a taxpayer is responsible for keeping records to verify the amount of income, sales, or other tax that he or she is responsible to pay.[3] In the absence of taxpayer-kept records, Respondent asserts that it may use whatever information becomes available to calculate assessments.[4]

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[3] Respondent's Trial Brief, citing *Greer v Dep't of Treasury*, 145 Mich App 248; 377 NW2d 836 (1985)
[4] Respondent's Trial Brief (RTB), p. 2

Respondent stated that after three attempts to contact the owner, it was unable to conduct an entrance conference prior to starting the audit. Respondent's auditor testified that the purpose of the entrance conference is to:

> . . . [ask] how sales are rung into the register, who the taxpayer's representative is, who their vendors are. We will talk about product markups, and then we will give them our request for records. . . . We would request purchase invoices, general ledger, bank statements, cancelled checks, federal tax returns, SBT's, sales tax returns, anything along those lines. . . . We will discuss the audit process . . . and then we will discuss appeals processes. . . .[5]

Respondent asserts that it was informed by Petitioner's attorney, Mr. Frank Polasky, that Petitioner's owner "would not, under any circumstances, be allowed to meet with the auditor." (RTB, p. 2) Respondent's auditor went forward with the audit based on the information made available, which included all requested information except bank statements, general ledgers and daily sales summaries. (Trans, p. 90) The auditor found that Petitioner did not have any "real internal controls." [6] After the audit was completed and submitted for approval, Petitioner's attorney contacted Respondent and requested the audit be reopened. Respondent granted the request based on Petitioner's assurance that the additional documentation would be provided. Respondent contends that no additional information was provided and there was no indication that Petitioner intended to provide any additional information. (RTB, p. 2)

Respondent's auditor testified that in conducting the audit he used a "block sample method," and that the "procedure is to sample two months to determine allowable food percentage and then that percentage is projected over the audit period." (Trans, p. 90) However in this case, Respondent contends that Petitioner requested a four-month sample. Respondent's auditor testified that he agreed to use the four-month sample and that the sample period was agreed to by Petitioner. (Trans, p. 90)

Respondent used the purchase invoices for the four-month sample period which were broken down into taxable and non-taxable categories. The auditor stated that he then used this "purchase spread and the categorical markups to determine an allowable percentage of the taxpayer's net sales that are nontaxable. [He] compare[d] this to what was actually reported, and then [he] adjust[ed] for a difference." (Trans, p. 91) Respondent maintains that the markup percentages used, in particular the 19.06% markup on beer, are correct. The auditor testified that the categorical markups were provided by Petitioner's accountant. He stated "[w]e received a fax where different beer products were detailed with their cost and their selling price." (Trans, p. 94)

Respondent contends that, based on the four-month sample analysis, the appropriate non-taxable food deduction was 41.96%, whereas the deduction taken by Petitioner ranged between 69% and 90% for each period under audit. This resulted in a disallowed percentage between 27% and 48% for each period.

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[5] Hearing Transcript (Trans), pp. 86 & 87
[6] Audit Report (AR), dated 3/21/2006, p. 2

Respondent also contends that it applied an appropriate allowance for theft, breakage and loss. Respondent's auditor testified that he allowed a three percent deduction despite the fact that Petitioner provided no documentation to support this or any other amount. He stated "We determined that . . . it was a high crime area. And based on auditor judgment, we allowed what was at the time a standard 3 percent allowance for theft." (Trans, p. 94) He further testified that "Anything above that we required documentation." (Trans, p. 103)

Respondent further contends that a taxpayer is responsible for keeping records to verify the amount of income, sales, or other tax that he or she is responsible to pay. Respondent's auditor testified that his justification for the 10% penalty "was because the disallowed food amount was very large and the fact that the taxpayer did not take appropriate care in his record keeping to ensure accurate tax reporting." (Trans, p. 110)

## FINDINGS OF FACT

Petitioner's retail business is located in an economically poor area and relies heavily on patrons using food stamps and other public assistance programs. Petitioner suffers from frequent thefts, including employee theft. Petitioner does not have procedures to record or otherwise keep track of theft, breakage or loss. Petitioner does not maintain documentation to support product mark-ups. Petitioner experienced an inventory increase of 29.05%, 14.16% and 6.64% in 2002, 2003, and 2004, respectively, for a total 57.17% increase ($29,140.00) during the audit period. Because Petitioner holds licenses and is authorized to accept "Bridge Cards" and WIC (Women, Infants and Children), a significant portion of Petitioner's sales are non-taxable food.

Petitioner's owner is Srmad Batris, who is not involved with the day-to-day operations. The store is under the management of Mr. Batris' brother, Peter Zora. Petitioner engages a third-party bookkeeper to compile financial information and prepare tax documents, including sales tax returns. Petitioner did not maintain all of its purchase/expense records on a monthly basis, but rather made an adjustment at year-end for as much as 20% of total expenses. Petitioner did not cooperate with Respondent's auditor, inhibiting his ability to efficiently conduct the audit. Respondent provided ample opportunity for Petitioner to participate in the audit process, including "reopening" the audit after it was initially submitted for approval. Petitioner did not make available all the documentation requested by Respondent.

## APPLICABLE LAW

The Sales Tax Act, 1933 PA 167, provides for the levy and collection of a sales tax on the transfer of ownership of tangible personal property. Section 2 of the Act, MCL 205.52, provides,

> (1) Except as provided in section 2a, there is levied upon and there shall be collected from all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, an annual tax for the privilege of engaging in that business equal to 6% of the gross proceeds of the business, plus the penalty and interest if applicable as provided by law, less deductions allowed by this act.

"Gross proceeds" means sales price. MCL 205.51(1)(b) "Sales price" is defined (in relevant part) under MCL 205.51(1)(d) as:

> (d) [T]he total amount of consideration, including cash, credit, property, and services, for which tangible personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, and applies to the measure subject to sales tax. Sales price includes the following…:
>
> (i) Seller's cost of the property sold.

Certain items sold by Petitioner are not subject to tax. Pursuant to MCL 205.54g, the following are exempt from the sales tax:

> (a) Sales of drugs for human use that can only be legally dispensed by prescription or food or food ingredients, except prepared food intended for immediate human consumption.

Respondent is granted authority to examine and audit Petitioner's records if it believes all taxes have not been paid. MCL 205.21 states:

> (1) If a taxpayer fails or refuses to make a return or payment as required, in whole or in part, or if the department has reason to believe that a return made or payment does not supply sufficient information for an accurate determination of the amount of tax due, the department may obtain information on which to base an assessment of the tax. By its duly authorized agents, the department may examine the books, records, and papers and audit the accounts of a person or any other records pertaining to the tax.

Taxpayers are required to maintain adequate records to ensure the appropriate taxes are paid. MCL 205.67, (repealed by P.A. 2008, No. 438, § 1, Imd. Eff. Jan. 9, 2009), states in pertinent part:

> (1) A person liable for any tax imposed under this act shall keep accurate and complete beginning and annual inventory and purchase records of additions to inventory, complete daily sales records, receipts, invoices, bills of lading, and all pertinent documents in a form the department requires…. If the taxpayer fails to file a return or to maintain or preserve proper records as prescribed in this section, or the department has reason to believe that any records maintained or returns filed are inaccurate or incomplete and that additional taxes are due, the department may assess the amount of the tax due from the taxpayer based on information that is available or that may become available to the department. **That assessment is considered prima facie correct for the purpose of this act and the burden of proof of refuting the assessment is upon the taxpayer**. [Emphasis added]

Regarding the imposition of the negligence penalty imposed by Respondent, MCL 205.23(3) provides:

> (3) . . . [I]f any part of the deficiency or an excessive claim for credit is due to negligence, but without intent to defraud, a penalty of $10.00 or 10% of the total amount of the deficiency in the tax, whichever is greater, plus interest as provided in subsection (2), shall be added. . . If a taxpayer subject to a penalty under this subsection demonstrates to the satisfaction of the department that the deficiency or excess claim for credit was due to reasonable cause, the department shall waive the penalty.

In addition, the Michigan Administrative Code provides:[7]

> Rule 23. (1) The department, through its field auditors and other employees, may examine the books, records and papers of any person liable for payment of the sales and use taxes. It may issue a subpoena requiring any person to appear for examination and produce any books, records or papers within the scope of the inquiry.
>
> (1) It is the duty of every person engaging in any business subject to the tax to keep and preserve suitable and adequate records of his business to enable such person, as well as the state, to determine the correct amount of tax for which he is liable.
>
> (2) **Failure to produce and keep records for the purpose of examination by the department will be considered willful noncompliance with the sales tax law and subject to its penalties.** In the absence of sufficient records the department may determine the amount of tax due the state by using any information available whether obtained at the taxpayer's place of business or from any other sources, and assess the taxpayer for any deficiencies, plus penalties. **[Emphasis added]**

Guidance for waiver of a negligence penalty is found the administrative rules at R205.1012, which provides:

> Rule 12. (1) Negligence is the lack of due care in failing to do what a reasonable and ordinarily prudent person would have done under the particular circumstances. The standard for determining negligence is whether the taxpayer exercised ordinary care and prudence in preparing and filing a return and paying the applicable tax in accordance with the statute. The facts and circumstances of each case will be considered.
>
> (2) When the department imposes a negligence penalty, the department bears the burden of establishing facts to support a finding of

[7] 1999 AC, R 205.23

> negligence and the taxpayer bears the burden of establishing facts that will negate a finding of negligence. The taxpayer shall file a written statement that explains, in detail, the facts which are relied upon to defeat the penalty and which constitute reasonable cause.

## CONCLUSIONS OF LAW

Michigan law places a duty upon each and every taxpayer to file returns and remit sales taxes as due. MCL 205.52(1) provides the statutory authority to collect a tax on sales from all persons engaged in the business of making retail sales. Moreover, MCL 205.23 gives Treasury the authority to assess taxes against a taxpayer who fails to pay the correct amount of tax. Taxpayers are responsible for keeping adequate records to verify the amount of income, sales, or other tax that he or she is responsible to pay.[8] When a taxpayer fails to supply complete or accurate information, MCL 205.21(1) allows Treasury to obtain information to determine how much tax is due. MCL 205.67(1) requires a taxpayer to keep accurate and complete records of sales and where a taxpayer fails to keep the required records, Treasury may use any available or obtainable information to calculate and assess the tax.

Michigan courts have upheld these statutory requirements. In *Vomvolakis v Department of Treasury*, 145 Mich App 238; 377 NW2d 309 (1985), the Court of Appeals affirmed the assessment of taxes against taxpayers who objected to Treasury's method of determining the amount of tax due. Despite their objections, the taxpayers provided no documentary evidence to rebut the assessments. The Court stated that it was the intent of the Legislature to give Treasury the authority to base assessments on "the best information that it could obtain."[9] Because of the taxpayers' failure to comply with statutory record-keeping requirements and their failure to present evidence to rebut the assessment, the Court affirmed the assessment.

Respondent in this case determined that the books and records provided by Petitioner were inadequate and failed to meet the statutory requirements. Respondent therefore based its audit conclusions on the best information available, as is consistent with MCL 205.67 and *Vomvolakis, supra*. The last sentence of MCL 205.67 establishes the burden of proof as being upon the taxpayer. The taxpayer must show that the assessments are improper, unlawful or inappropriate and what, if any, is the correct and proper tax liability.

The Tribunal finds that it is not clear to what extent Petitioner did or did not maintain accurate and complete records. Respondent maintains that it did not receive all documents requested whereas Petitioner's attorney indicated that the records were available but argued that they were simply too complex to be discussed over the phone. Nevertheless, it is clear that Petitioner failed to cooperate with the audit process and provide the requested documentation to the auditor, either with an entrance conference or when the audit was reopened at Petitioner's request. Had Petitioner cooperated, the parties may have been able to mutually agree to certain assumptions such as the mark-up percentage on beer and wine. The time and expense of litigating this case may have been avoided.

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[8] See *Greer v Department of Treasury*, 145 Mich App 248; 377 NW2d 836 (1985).
[9] *Vomvolakis v Department of Treasury*, 145 Mich App at 244

At hearing, Petitioner put forth a calculation of what it contends is an accurate determination of tax. It engaged the services of a Certified Public Accountant, Margaret Rokita, who was not otherwise involved with the audit at issue nor with the preparation of Petitioner's tax returns. Petitioner's counsel stated that Ms. Rokita was asked to review the audit schedules and identify errors. Based on her work papers and testimony, Ms. Rokita also made certain adjustments and assumptions. She concluded that Petitioner's underpayment of tax should be $17,500.00 rather than the $38,446.00 as determined by Respondent.

The first adjustment proposed by Petitioner's CPA witness was a 15% increase in total purchases, all assumed to be for non-taxable food. Petitioner argued that the purchases supported by the general ledger/financial statements are 20% lower than the amount reflected on the corporate tax returns. Ms. Rokita testified that "at the end of the year . . . [they found] different receipts and check purchases that weren't in the envelopes that were given to the bookkeeper." (Trans, p. 63) On her calculation schedule, Ms. Rokita wrote "There appears not to be final cost/expense adjustments being made to the GL/financial statements, as inventory purchases and administrative expenses per the income statement are lower than reported on the tax returns."[10] She continues, "It is likely that these purchases would be for food as there are many more food vendors, rather than beer/wine/cigarette vendors, to go out and purchase items from." *Id.* This is strictly speculation and Petitioner brought forth no credible evidence to support such an argument. Ms. Rokita also testified that she actually used only 15% because "20 percent seems pretty high to make an adjustment there." (Trans, p. 63) Neither Petitioner nor Ms. Rokita provided any evidence to support a claim that such adjustment should be for non-taxable food. The Tribunal finds this adjustment unjustified.

The second adjustment suggested by Petitioner's CPA was an increase in the deduction for theft from three percent to five percent. On her schedule, Ms. Rokita wrote "[Petitioner] states that theft is larger than 3% . . . It is difficult to determine the amount of theft." She seems to argue that because food stamps, soup kitchens and food pantries are available for low income families, alcohol and tobacco products must make up the entirety of stolen goods. However, Petitioner does not maintain any records regarding theft or breakage. Its witness/assistant manager testified that they have no policies or procedures to track thefts; they keep no record of losses or spoiled products. Respondent's auditor testified that it is standard procedure to allow a three percent reduction where the taxpayer is able to show that it is located in a high crime area. He further indicated that a higher percent is permitted only where the taxpayer can provide documentation to show that a higher rate is appropriate. The Tribunal finds that Petitioner did not provide credible evidence to show that a deduction for theft should be other than the three percent permitted by Respondent. The Tribunal finds further that a 3% theft adjustment should be applied to all categories including non-taxable food.[11]

Petitioner does not dispute the mark-up percentages used for non-taxable food, cigarettes and other taxable items; however, it contends that the mark-up for beer and wine is no more than 10%, not the 19.06% applied by Respondent. Ms. Rokita testified that she did not look at the

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[10] Petitioner's Recalculation of Auditor Findings
[11] Respondent provided no explanation as to why it did not apply the 3% deduction to non-taxable food in its audit calculations.

mark-up on beer and wine, but because of "the middleman, the beer distributors make all the profit." (Trans, pp. 59 & 60) She also stated that "cigarettes is [sic] the same way. You don't make much on cigarettes . . . they make their money from the rebate from the cigarette companies." (Trans, p. 60) Petitioner's only evidence as to the mark-up on beer and wine was an affidavit that was not allowed into evidence. Respondent determined the average mark-up on beer/wine based on information provided by Petitioner during the audit. Despite promising to provide testimony to support a different mark-up, Petitioner has failed to prove otherwise.

Petitioner maintains that 60% of its total sales are non-taxable food. Peter Zora, store manager, testified that the business is primarily reliant on its licenses to accept Bridge Cards and WIC. He stated that "[w]ithout those two licenses the store would not open." (Trans, p. 33) Beer is sold "just to draw out [business] . . . there's not much of a markup on beer . . . we have to [sell it] just because - - to complete operation of the store business." (Trans, p. 33) Petitioner's CPA determined that the sale of non-taxable food is closer to 54.61% but stated that the calculation is a rough estimate, the average markups are rough estimates, and the sample period may not be representative of the entire audit period. The Tribunal finds that Petitioner has provided no evidence to support its contention that 60% of its non-liquor sales are non-taxable.

Ms. Rokita testified that she found four additional purchases not on the auditor's list in a total amount of $881.00. She stated that these invoices were for non-taxable items but that the amount was not material in this case. (Trans, p. 56) The Tribunal finds these invoices credible and the purchase of non-taxable food for the sample period should be increased by $881.

The corporate tax returns show an increase in inventory from 2001 to 2004, of approximately $29,000. Petitioner's CPA argues that it is reasonable that inventory would increase in the beer/wine category rather than the perishable food category. Not only is there no documentary evidence to support this claim, Mr. Zora testified that the increase was probably "a little bit of everything. . . . I can't really itemize it or break it down . . . the store is full of a lot of merchandise . . . ." (Trans, p. 37) He further stated that "it can't be beer because there's a date on the beer. You can't storage (sic) beer." *Id.* An increase in beer and wine would also be counter to Petitioner's argument that they sell it only to draw out business for the Bridge Card and WIC sales. The Tribunal finds that an adjustment should be made to reflect the increase in inventory. The total increase of $29,140.00 times the purchase spread for each category should be used to determine an amount for the sample period, as follows:

| **Category** | | **% of total purchases** | **Total Inventory Increase** | **Average Inventory Increase in 4-Month Sample Period** |
|---|---|---|---|---|
| liquor | | 40.13% | $ 11,692.46 | $ 1,140.73 |
| beer/wine | | 24.47% | $ 7,129.82 | $ 695.59 |
| cigs | | 11.25% | $ 3,279.70 | $ 319.97 |
| taxable | | 3.13% | $ 912.63 | $ 89.04 |
| food | | 20.94% | $ 6,102.82 | $ 595.40 |
| stamps | | 0.08% | $ 22.56 | $ 2.20 |
| | | 100.00% | $ 29,140.00 | $ 2,842.93 |

Ms. Rotika testified that all beer and wine invoices were added for the year 2004 and the average purchases for a four month period came to $51,653.00. The Tribunal finds this average to be supported by documentation and therefore the average monthly purchase should be adjusted accordingly.

Petitioner failed to present any evidence or testimony in support its contention that the four-month sample period is incorrect because it does not reflect the allegedly higher purchasing activity during the Thanksgiving and Christmas holiday season. In fact, Respondent's auditor testified that Petitioner asked for and agreed to the four-month sample period. Therefore, the Tribunal finds no adjustment should be made based on this argument.

Based on the adjustments above, the Tribunal finds that the underpaid tax is $36,547.00.

Finally, Petitioner argues that it should not be subject to the 10% negligence penalty because it provided all of its financial records to a third-party accountant who prepared the sales tax returns on its behalf. Petitioner maintains that it reported to the best of its knowledge all sales and, therefore, "should not be liable for the additional tax [and penalty] as established by the State of Michigan." However, Petitioner admits that it made a 20% adjustment to expenses at the end of the year, which was never reported for sales tax purposes. Notwithstanding that Petitioner under-reported sales, the Tribunal finds Petitioner's failure to adequately maintain records for the purpose of examination by Respondent was willful noncompliance with the sales tax law and warrants penalty pursuant to MCL 205.23. A penalty based on the adjusted underpaid tax is affirmed.

## JUDGMENT

IT IS ORDERED that Assessment N638376 be revised to reflect the amount of tax owed as $36,547.00.

IT IS FURTHER ORDERED that Respondent recalculate interest and penalty based on the revised tax owed.

IT IS FURTHER ORDERED that the officer charged with collecting the affected taxes, interest, and penalties shall collect the taxes, interest, and penalties as required by this Order within 28 days of the entry of this Final Opinion and Judgment.

This Final Opinion and Judgment resolves all pending claims in this matter and closes this case.

MICHIGAN TAX TRIBUNAL

By: Cynthia J Knoll

Entered: November 12, 2010