

STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

BF Enterprises, Inc.,
Petitioner,

v

MTT Docket No. 440243

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
B. D. Copping

FINAL OPINION AND JUDGMENT

INTRODUCTION

Petitioner, BF Enterprises, Inc., appeals a sales tax assessment issued by Respondent for the tax periods May 1, 2006, through April 30, 2010. The Tribunal finds that the related Assessment No. TH72122 is affirmed.

BACKGROUND

The hearing took place at the Tribunal in Dimondale on April 24, 2013. Petitioner was represented by his accountant, Abraham Nunu, CPA, and Respondent was represented by Randi Merchant, Assistant Attorney General.

Petitioner is a convenience store and gas station, FEIN 38-XXXXXXX. The issue relates to a sales tax compliance audit conducted by Respondent, which resulted in the following assessment:

Assmt #	Period	Type	Tax	Penalty	Interest*	Total
TH72122	5/1/2006 – 4/30/2010	Sales	\$729,070	\$72,907	\$165,850+	\$967,827+

*Interest accruing and to be computed in accordance with sections 23 and 24 of 1941 PA 122.

PETITIONER'S CONTENTIONS

In Petitioner's opening remarks, it stated:

Your Honor, we are here today for a sales tax audit for my client, and this audit was done by the State of Michigan based on estimates of a two-month sample for the whole audit period. And we feel that estimate, which has changed over the course of the audit at least three times, it's excessively high. It doesn't present the reality of that business and we feel that estimate need to be revised because the estimates has changed dramatically during the course of the audit and that will be -- put my client in a very bad shape to continue his business and destroy him. (Transcript, p. 10)

In Petitioner's prehearing statement, it contended:

The Petitioner has cooperated with the auditor and provided him with information that he requested. The auditor estimated an assessment amount based on a sample of two months which did not represent the whole audit. The Petitioner believes that there is a mistake and an error in the estimate number. The Petitioner is a gas station business and most of the sales tax is prepaid at the wholesale level. The Petitioner is a small gas station with a 700 sq. ft. C-Store. The amount assessed by the auditor is outrageous and would put the Petitioner out of business.

In addition to Petitioner's contention that the use of estimates resulted in an assessment that was excessively high, it also argues that the auditor's treatment of

the taxation of prepared foods was incorrect. He stated that other stores selling prepared foods do not charge sales tax on the sale of those types of products.

Assmt #	Period	Type	Tax	Penalty	Interest*	Total
TH72122	5/1/2006 – 4/30/2010	Sales	\$0	\$0	\$0	\$0

*Interest accruing and to be computed in accordance with sections 23 and 24 of 1941 PA 122.

PETITIONER'S ADMITTED EXHIBITS

Petitioner failed to submit an exhibits list; however, as his only exhibit was the initial audit report issued by Respondent, Respondent had no objection to its admittance.

P-1: Audit Report of Findings and supporting schedules dated, October 7, 2010.

When asked by the Tribunal why Petitioner had not provided either a witness or an exhibit list, as required by the Tribunal's Order, Petitioner replied, "[H]onestly I didn't have an idea that it was our responsibility." (Transcript, pp. 5-6) When asked by the Tribunal if he had read the Order, Petitioner stated, "No. I didn't get copy of it, to be honest with you." (Transcript, p. 6)

PETITIONER'S WITNESS

Similarly, Petitioner also failed to submit a witness list.

Petitioner stated that it did not have any witnesses, and it was only going to cross-examine Respondent's witness.

RESPONDENT'S CONTENTIONS

In Respondent's opening remarks, it stated:

This case involves Petitioner's sales tax liability. Treasury maintains that the assessments at issue here should be upheld. MCL 205.68(4) - subsection four -- sets forth an assessment which is prima facie correct and Petitioner bears the burden to refute the assessment. Petitioner has utterly failed to do so in this case.

The assessment at issue -- the main complaint Petitioner has is that it was calculated based on estimates. This is specifically provided for in the statute. Treasury is authorized to make assessments based on estimates when they do not have the full amount of records available to them. Petitioner has indicated in its opening statement that the assessments have changed over time. Treasury does not dispute this. The estimates changed as more information became available to Treasury. And each time additional information was made available to Treasury, it resulted in the assessment increasing because that was what the records provided by Petitioner -- however slim they were -- demanded the results should be.

Treasury intends on calling the auditor in this case, Justin Storey, and we anticipate that he will testify as to the audit he conducted and the conclusions he reached. We are confident that when the evidence is entered it will support the challenged assessment. And at the conclusion of the hearing we will ask the Tribunal to affirm the assessment and reject the claims of the Petitioner. (Transcript, pp. 11-12)

Assmt #	Period	Type	Tax	Penalty	Interest*	Total
TH72122	5/1/2006 – 4/30/2010	Sales	\$729,070	\$72,907	\$165,850+	\$967,827+

*Interest accruing and to be computed in accordance with sections 23 and 24 of 1941 PA 122.

RESPONDENT'S ADMITTED EXHIBITS

- R-1: Audit Report of Findings and supporting schedules.
- R-2: Amended Audit Report of Findings and supporting schedules.
- R-3: Notice of Preliminary Audit Determination dated August 24, 2011.
- R-4: Final Audit Determination Letter, dated September 20, 2011.
- R-5: Tax Compliance Records Request.
- R-6: November 15, 2010 correspondence from Treasury to Petitioner.
- R-7: July 14, 2011 correspondence from Treasury to Petitioner.
- R-8: July 29, 2011 correspondence from Treasury to Petitioner.
- R-9: February 27, 2012 correspondence from Treasury to Petitioner.
- R-10: Audit Diary.
- R-11: Intent to Assess.
- R-12: Final Assessment.

RESPONDENT'S WITNESS

Justin Storey

Mr. Storey testified he is a senior auditor with the Michigan Department of Treasury. He has a bachelor's degree from Central Michigan University with an emphasis in accounting and a Master's of Science in Accounting degree from Grand Valley State University.

Respondent asked Mr. Storey, “For sales tax audits in general what is the general objective when conducting a sales tax audit?” (Transcript, p. 14) Mr. Storey replied, “The general objective is to verify the taxpayer's reported figures and determine if any adjustments are necessary.” (Transcript, p. 14)

Respondent went on to ask, “What do you generally look at when you're conducting an audit of the records of the taxpayer?” (Transcript, p. 15) The witness replied, “The records, we would look at profit and loss statements, purchase invoices, check stubs, federal tax returns, general ledgers and, really, I mean anything else.” (Transcript, p. 15)

When asked to describe what “block sampling” was and whether it was an acceptable audit method, Mr. Storey stated, “Block sampling is to select a block -- a block of time period and review the records from that period and project that over the audit period.” (Transcript, p. 16) He also confirmed that he believed it was an acceptable audit method.

When asked to describe how the audit was initiated, Mr. Storey testified, “The audit was initiated with an unannounced entrance conference. I stopped by the store without providing any, you know, prior notice that I was going to be showing up and asked to speak with the owner.” (Transcript, p. 16)

Mr. Storey stated he “was able to speak with the owner on the phone and was given permission to speak to the store manager.” (Transcript, p. 16) Mr. Storey stated the following with respect to talking with the store manager:

On the first day we like to get answers to how merchandise is rung up on the cash register, basic reporting at the store, do they print sales reports from the register, are those recorded, what records they provide to their accountant to prepare the monthly and annual financial statements. (Transcript, pp. 16-17)

The store manager answered his questions, “[f]or the most part.” (Transcript, p. 17)

When asked to describe the gas station/C-Store (Convenience Store), Mr. Storey testified, “It was quite a bit more extensive. They had several pumps dedicated to regular gas but also several pumps that appeared dedicated to diesel fuel. As far as the fuel setup, it was more of a truck stop with numerous pumps.” (Transcript, p. 18) When asked by Respondent whether the store was located by a major highway, the witness responded it was located adjacent to I-96.

When asked who his contact was for the rest of the audit, Mr. Storey stated, “My main contact was the accountant, Mr. Nunu.” (Transcript, p. 19)

When asked by Respondent, Mr. Storey clarified that the audit covered both gasoline and merchandise sales from the convenience store.

When asked if he received the records requested in Exhibit R-5, Mr. Storey replied that he did not and that he had made numerous attempts to obtain them.

The witness then clarified that he did not initially receive any of the records he requested, but he did receive some of the records at a later date. Those records included purchase invoices and daily sales summaries for one month for April 2009, as well as 2006 through 2009 federal 1120 tax returns and annual sales tax returns for 2007 through 2009.

Mr. Storey testified that his initial audit report was based on one-month of data. (Exhibit R-1) The initial audit was revised when Petitioner provided additional records at the time the informal conference was held. This resulted in a revised audit report. (Exhibit R-2)

Mr. Storey also testified that Petitioner was given numerous opportunities to provide additional documentation. This testimony was supported by his audit diary (see Exhibit R-10) and Exhibits R-6 through R-9, which are copies of faxes sent to Petitioner granting it additional time to provide the requested documentation.

When asked by Respondent if he used the April 2009 sales records provided by Petitioner to calculate Petitioner's initial tax due, the witness stated he did.

Respondent asked Mr. Storey, "Did you end up obtaining records from entities other than Petitioner in order to calculate Petitioner's tax liability?" (Transcript, p. 23) Mr. Storey said that he did and went on to describe what information he had requested and received from third parties: "I requested

information from some of their vendors to get [Petitioner's] merchandise purchases for the sample period.” (Transcript, pp. 23-24) When Respondent asked, “Were they helpful in determining Petitioner's sales tax liability,” Mr. Storey replied that they were. (Transcript, p. 24)

Mr. Storey then testified that he had used the records obtained from the fuel suppliers to determine how much fuel Petitioner had purchased. Specifically, the witness referred to Petitioner's fuel purchases on Schedule H-1 of Exhibit R-1. With respect to this schedule, when asked by Respondent what the primary cause of the audit adjustment was, Mr. Storey stated, “The primary cause of the adjustment was an adjustment to gross sales of eight million three hundred forty thousand one hundred and forty dollars.” (Transcript, pp. 25-26)

Respondent inquired of Mr. Storey, “How did you determine that Petitioner's gross sales had been under reported to that extent?” (Transcript, p. 26) Mr. Storey replied:

Well, it started with their fuel. The amount of fuel that they purchased let us know that they were severely under reporting their gross sales. For the three years where we had taxpayer information and comparative vendor information, we determined that their fuel purchases alone was approximately five million dollars more than the sales that they were reporting on their federal tax return. So from that point we calculated a gross sales adjustment, using our determined fuel sales and then a projected amount for merchandise. (Transcript, p. 26)

Mr. Storey testified that following the issuance of Respondent's initial audit report, Exhibit R-1, Petitioner sought and was granted an informal conference in which Mr. Storey participated. At the informal conference, Petitioner provided additional documents, which were incorporated into and were used to revise the audit report – the result being an increase in the amount of the assessment.

When Respondent asked Mr. Storey about the reasons for the increase, he stated, “Well, the one issue was adding the second month to our projections increased it, but we also had to make an adjustment for prepared food sales that were not included in the original sales determination.” (Transcript, p. 28) These changes were reflected in the first revised audit report, Exhibit R-2.

Respondent asked, “I see that you used a one hundred percent markup when you were determining Petitioner's gross sales of prepared food. What was the basis for using that markup?” (Transcript, p. 29) The witness replied, “That is the standard markup that we use on prepared food when the taxpayer has not provided their own markup information.” (Transcript, p. 29)

Respondent then asked Mr. Storey, “On page six to seven of R-2 of the amended audit report of findings does your report include a detailed description of the deduction for food for human consumption, and explain why that was adjusted?” (Transcript, p. 29) He responded:

The adjustment was due to our analysis of the taxpayer's allowable food percentage. The purchase invoices for the two-month sample were detailed and broken down into various taxable and nontaxable categories. We then calculate what percentage of food purchases are to the total purchased. And in that case then that percentage was applied to the merchandise sales to determine the accuracy of their purported food deduction and we determined that their food deduction was overstated. (Transcript, p. 30)

When asked, Mr. Storey went on to testify, with respect to food percentage, e.g., the amount of exempt food sales, as opposed to sales of taxable food and other merchandise, “That was based on their records plus the information obtained from the vendors directly.” (Transcript, p. 30) Mr. Storey then confirmed that Respondent does attempt to crosscheck that information to the extent possible.

To Respondent’s question, “Coming back to Petitioner's main claim in this case that its tax liability was determined using estimates, do you agree estimates were used in this case,” the witness replied that he agreed. (Transcript, p. 39)

Mr. Storey went on to confirm that in the absence of actual records, estimating Petitioner’s tax liability using this methodology is appropriate and that this method, which was used for calculating the taxpayer's tax liability, is specifically authorized by statute.

Mr. Storey again explained why the initial audit adjustment was substantially less than subsequent audit adjustments, as follows:

It's less because this -- this audit determination was based on what information I had available at the time, which was only the amount of

the prepaid sales tax credits and then the annual [SUW] returns. So we didn't -- we didn't know of the understatement of the gross sales because we hadn't gotten records. Because we had to assume at this time that gasoline sales were the only sales because our fuel sales was calculated based on the prepaid credits that were reported by the taxpayer. And there's no prepaid on diesel. (Transcript, pp. 40-41)

Respondent then asked, "So once you received the additional records from Petitioner's fuel vendor, would that explain the large increase from these documents or from this document to your initial audit report of findings?"

(Transcript, p. 41) The witness responded, "Yes". (Transcript, p. 41)

The witness was then cross-examined by Mr. Nunu, Petitioner's representative. Petitioner began its cross-examination by asking Mr. Storey how he had calculated the prepared food estimate and associated sales tax. Mr. Storey testified:

My prepared food estimate was based on purchase invoices and information from the purchase side of it, and then the fact that the store manager told me that they have a separate register back there that is not connected to their main register. That's why it was not dealt with originally. (Transcript, p. 44)

When asked to explain the difference in taxability for certain prepared foods, Mr. Storey stated:

If the taxpayer is making sandwiches on site and just selling them, say, four dollars a sandwich, then it is a taxable sale. It's only nontaxable if it's sold by weight or unit. So I mean the instance that you were describing where they were making sandwiches to order or making them beforehand and putting them in the cooler, that would be a taxable item. (Transcript, pp. 44-45)

Mr. Storey went on to clarify, “If they prepared it before and put it in a cooler, but were selling it as is, like, for example, four dollars per sandwich and not selling it by weight, then it's a taxable item.” (Transcript, p. 45)

Petitioner asked Mr. Storey to confirm the basis on which the price per gallon is based. “So you based your prices for this audit on the Midwest regional; correct?” (Transcript, p. 49) Mr. Storey responded, “Correct, because actual records weren't provided.” (Transcript, p. 49)

Petitioner asked the witness, “If you don't have the documents how do you -- how do you figure that amount?” (Transcript, p. 50) Mr. Storey answered, “The fuel sales were determined using the gallons purchased from the vendor and the Midwest regional price per gallon, and those were projected out to calculate the gasoline sales for the entire audit period. The merchandise sales were based on two months that were provided.” (Transcript, pp. 50-51) When asked by Petitioner if these numbers were projected or estimated, the witness responded, “Right, estimated, based on the two months of information that was provided.” (Transcript, p. 51)

Petitioner then asked, “How do you increase other issues -- the other items beside the gasoline?” (Transcript, p. 51) Mr. Storey responded, “Those items were increased based on the two months of information that were provided. We

calculated a ratio of merchandise sales to gallons of fuel purchased and then applied that throughout the audit period.” (Transcript, p. 52)

Petitioner asked the witness, “You think that's enough to represent the whole audit period?” (Transcript, p. 52) Mr. Storey responded, “Yes”. (Transcript, p. 52) Petitioner then asked, “What basis and what matters [do] you use to project that whole period?” (Transcript, p. 52) Mr. Storey answered, “My basis was the absence of actual records. That was the best available information that it had, so that's what I was forced to use.” (Transcript, p. 52)

When asked how a two-month sample would be projected out into a four-year audit period, the witness replied:

For the merchandise sales in this case, we took the merchandise sales that we got off their actual daily sales reports, calculated their total merchandise and then divided that by the gallons of gasoline that they purchased -- or, gallons of fuel that they purchased to get an approximate merchandise sales to gallon ratio. Then we apply that ratio to their gallons purchased for the rest of the audit period that we got from the fuel vendor and calculated our merchandise sales that way. (Transcript, pp. 52-53)

Petitioner then said, “I'm having a problem. How you use a ratio between the merchandise and gallons? There's no relevance, you know.” (Transcript, p.

53) Mr. Storey testified:

Well, the gallons seems to be the most stable number, because like you said, the price of gas can fluctuate so much that the easiest thing to base it off from is the gallons of gasoline purchased because that

remains relatively static. The price changes but the gallons generally doesn't. (Transcript, p. 53)

When asked to explain the rationale for the relationship of gallons of gasoline sold to merchandise sold in more detail, the witness stated:

The -- well, the projection that we applied, which, you know, as we've discussed, was only done because of the lack of actual information, would assume a correlation between merchandise sales and gallons purchased. But that was our best way that we could use the taxpayer's actual information for the two months to project merchandise sales for the audit period. We didn't have any other information available to us. (Transcript, p. 53)

Petitioner asked the witness, "Do you have any standards that prove that those – the two-month sample would be enough to cover a whole forty-eight-month period?" (Transcript, p. 54) Mr. Storey responded, "The two-month sample is our standard procedure for sampling purchases." (Transcript, p. 54)

With respect to how total merchandise sales for the four-year audit period were calculated, Mr. Storey testified:

Well, I used the merchandise sales reported on the daily sales reports to calculate the ratio of merchandise sales to gallons of fuel purchased. So I didn't use a purchase number and apply a markup, I used the reported sales. So whatever markups are included in that sales figure were determined by the taxpayer as a normal course of business. (Transcript, p. 58)

Mr. Storey then explained in detail how the ratio, between merchandise sales and sales of gallons of gasoline and diesel fuel, was calculated:

I'm on Schedule G5, page 44 of Exhibit R-2. So the top section is just a listing of the merchandise sales reported by the taxpayer on their daily sales reports. We added that up to get our total merchandise of one hundred seventy-three thousand. Then we added up the gallons purchased of diesel and gasoline to get the total fuel gallons purchased of four hundred eighteen thousand nine hundred seventy-seven. Then I took the total merchandise, divided it by the gallons purchased to determine the ratio of merchandise sales to fuel purchases of 41.3124 [percent]. (Transcript, p. 59)

When asked how these numbers are extended for the audit period, Mr. Storey testified, "If you flip to the next page, page 45, you'll see across the top the taxpayer's gallons of fuel purchased for the entire audit period, diesel and gasoline, and then the total. And we apply that percentage that we calculated to estimate the merchandise sales for the audit period." (Transcript, p. 60)

When asked to further explain why this is done this way, the witness testified:

We had to do this because those daily sales reports and profit and loss statements were not provided for any other period besides the two months. And the fact that the gasoline purchases were so much higher than the taxpayer's reported sales, we determined that there was really no part of their sales that we could trust as accurate. Because we already determined just looking at purchases that they were at least a couple million dollars understated. So this is -- this is our best information that we have to determine the taxpayer's actual merchandise. (Transcript, p. 60)

The witness was asked to explain the estimate of prepared food sales line on the previously referred to schedule. Mr. Storey explained:

That number actually comes from the next schedule, page 46. We took the taxpayer's prepared food purchases for our sample period, and in this case we essentially had to use a monthly average. We determined annual purchases of sixty-two thousand, added a hundred percent markup, to determine annual amount of prepared food sales, divided that by twelve to get our monthly average prepared food. And then underneath that we multiplied our monthly amount times the months in the audit period for each of the years. (Transcript, pp. 60-61)

Mr. Storey was then asked how he would distinguish prepared food sales from estimated merchandise sales. He responded, "Because they had told me at the entrance conference that they had a separate cash register back in their deli section that was not tied to their main register, so those prepared food sales were not carried over to their daily sales reports." (Transcript, p. 61) Thus, when asked, the witness agreed that the estimate of merchandise sales did not include prepared foods.

Petitioner then asked the witness, and the witness confirmed, that he had "assumed all the prepared food is taxable." (Transcript, p. 61) Petitioner then inquired, "Do you think this is a fair relation, gallons to dollars?" (Transcript, p. 64) Mr. Storey responded, "I think in the absence of actual records it is our best way to project, yes." (Transcript, p. 64)

When asked to explain the basis for using that correlation, Mr. Storey testified:

Just that the gallons purchased seems to be more, you know, steady as a -- like a baseline for our projection than anything else. As they discussed, the price of gas can go up and down, so that fluctuates quite a bit, so that's not -- gas sales is not a good projection method.

And since the sales tax reported by the taxpayer is reported by their gasoline sales, we can't really project off of the sales tax because that fluctuates the same as the gasoline sales. So we have found that the gasoline gallons tends to be the most stable figure for our projections. (Transcript, pp. 64-65)

Petitioner attempted to make the point that the audit results were based on estimates. Mr. Storey confirmed this by saying, "Each of the determinations was based on the best available information I had at the time." (Transcript, p. 69)

Petitioner stated he wanted to "go back to the prepared food item. Why you consider all of it taxable? Just I like to understand that." (Transcript, p. 69) Mr. Storey stated, "Well, based on the lack of records showing otherwise, then the questions that were asked at the entrance conference we determined it would all be taxable." (Transcript, p. 69) Petitioner then asked, "Who is we determined?" (Transcript, p. 69) Mr. Storey answered:

Well, I discussed with the store manager at the time of the entrance conference and he let me know that they -- the sandwiches were not sold by weight or measure, which would be the first thing to indicate to me that they were taxable. If they were making the sandwiches on-site and not selling them by weight or measure, then they would be taxable. (Transcript, pp. 69-70)

When asked by Petitioner, Mr. Storey explained that he based the tax assessed on the sale of prepared food on "what was sold from the deli register because I was not provided any records. The amount that I charged as prepared

food was based off of the prepared food purchases, which would not include any of those pop items.” (Transcript, p. 70)

When asked to explain prepared food purchases, Mr. Storey testified:

When we detail the purchases, the actual invoices into our different categories, we have a specific category for prepared food. We would put in there any of the ingredients that would go into making those sandwiches, and they're pretty easy to pick out because they come from, like, a Sysco or a Gordon Foods.

The pop that he is talking about, the bottled pop, would have come from a Coke or Pepsi vendor, which would have entered as a nontaxable category automatically. The prepared food purchases that we detailed for the two months were the purchases that we used to extrapolate out to our projected purchases that we then applied for the audit period. So that prepared food sales amount wouldn't include any of those pop or other cooler items, if they were things like bottled pop or, you know, similar to that. (Transcript, pp. 70-71)

The witness was asked, “As far as the invoices from, like, a Gordon Foods, did you review the specific items on the invoice to make sure they were for prepared food items?” (Transcript, pp. 73-74) He responded, “I would have scanned through each one as I was entering them, but anything that didn't stand out as obviously nontaxable would have just been assumed to have been prepared food.” (Transcript, p. 74)

On redirect examination, Respondent asked, “Isn't it also true that you only received one month during the initial audit period and that you did not receive that second month until after your audit conclusions had been reached?” (Transcript, p. 76) Mr. Storey confirmed this statement. Respondent then asked, “If you had

received that second month as requested during the initial audit period would the initial assessment have been higher?” (Transcript, p. 76) Mr. Storey again responded in the affirmative.

With respect to the use of estimates, Respondent asked, “Several of the questions directed to you during cross-examination involved the fact that you used estimates rather than all figures for the taxpayer's business activity. Do you dispute that some of your figures were extrapolations?” (Transcript, p. 76) The witness responded, “No”. (Transcript, p. 77)

Respondent then asked the witness if the use of estimates was an acceptable audit practice and whether it “[i]s it your understanding that Treasury is specifically authorized by statute to make such extrapolations when you do not have additional records available to you?” (Transcript, p. 77) Mr. Storey responded “yes” to both questions. (Transcript, p. 77)

Respondent then said, “There was also questions related to the fact that your audit figures changed as time went on during the audit. You agree that those figures changed; is that correct?” (Transcript, p. 77) Mr. Storey again responded, “Yes”. (Transcript, p. 77)

FINDINGS OF FACTS

Based on the exhibits provided by the respective parties and the testimony of the one witness, Mr. Storey, at the April 24, 2013 hearing, the Tribunal finds the following:

1. Petitioner is BF Enterprises, Inc., FEIN 38-XXXXXXX, a convenience store/gas station located in Webberville, Michigan.
2. Mr. Storey was the senior auditor assigned to the audit by the Michigan Department of Treasury.
3. He has a bachelor's degree from Central Michigan University with an emphasis in accounting and a Master's of Science in Accounting degree from Grand Valley State University.
4. The general objective of a sales tax audit is to verify the taxpayer's reported figures and determine if any adjustments are necessary.
5. The records requested by the auditor included profit and loss statements, purchase invoices, check stubs, federal tax returns, general ledgers, and any other relevant records, as determined by the auditor.
6. The audit was conducted in part using a two-month block-sampling method.
7. The audit was initiated with an unannounced entrance conference, where the auditor stopped by the store without providing any prior notice and asked to speak with the owner.
8. The auditor talked with the store owner on the phone and was given permission to speak to the store manager.
9. During the conversation with the store manager the auditor asked about how merchandise was rung up on the cash register, basic reporting at the store, do they print sales reports from the register, are those recorded, and what records they provide to their accountant to prepare the monthly and annual financial statements. The store manager answered the auditor's questions for the most part.
10. Petitioner's business consisted of a gas station and C-Store (Convenience Store) that had several pumps dedicated to regular gas, but also several pumps that appeared dedicated to diesel fuel. The gas station was set up as more of a truck stop with numerous pumps and was located adjacent to I-96.

11. The auditor's main contact person was the business's accountant, Mr. Nunu, CPA, who also represented Petitioner at the hearing.
12. The audit covered gasoline and merchandise sales from the convenience store.
13. After making numerous attempts to obtain requested records from Petitioner, the auditor finally received some of the records requested, which included purchase invoices and daily sales summaries for one month for April 2009, as well as 2006 through 2009 federal 1120 tax returns and annual sales tax returns for 2007 through 2009.
14. The initial audit report was based on one-month of data. (Exhibit R-1)
15. The initial audit report was revised twice, as a result of Petitioner providing additional records. The result of both revisions was based on the additional data provided by Petitioner, the discovery that the deli section of the store had a separate cash register, and the transactions from the sale of prepared foods rung up on that register were not included in the original audit.
16. The auditor used the April 2009 sales records provided by Petitioner to calculate Petitioner's initial tax due.
17. Due to the lack of adequate records, the auditor obtained additional information from third-party vendors.
18. The auditor used the records obtained from the fuel suppliers to determine how much fuel Petitioner had purchased. Specifically, Petitioner's fuel purchases are found on Schedule H-1 of Exhibit R-1.
19. As a result of obtaining these records from Petitioner's fuel suppliers, an adjustment to gross sales of \$8,340,140 was made.
20. The magnitude of this adjustment clearly demonstrated (and was not refuted by Petitioner) that Petitioner was severely underreporting its gross sales, which justified the imposition of at least the 10% negligence penalty.
21. Petitioner sought and was granted an informal conference. At the informal conference, Petitioner provided additional documents, which were incorporated into and were used to revise the audit report – the result being an increase in the amount of the assessment.
22. The audit adjustment was due, in part, to adding the second month to the auditor's projections and making an adjustment for prepared food sales that were not included in the original sales determination. These changes were reflected in the first revised audit report, Exhibit R-2.
23. The auditor used a 100% markup when he determined Petitioner's gross sales of prepared food. This was the standard markup used by Respondent

on prepared food when the taxpayer has not provided its own markup information.

24. The adjustment for applying sales tax to the sale of prepared foods was based on Petitioner's records, plus the information obtained from the vendors directly.
25. It was appropriate for Respondent to base the audit on estimates utilizing block sampling of Petitioner's data and third-party invoices, due to the absence of actual records and the significant underreporting of gross sales by Petitioner.
26. MCL 205.68(4) specifically authorized Respondent to "assess the amount of the tax due from the taxpayer based on information that is available or that may become available to the department."
27. Petitioner sold prepared foods, e.g., sandwiches made on the premises, sealed, and placed in a cooler for sale. The food ingredients were purchased separately and then used to make the sandwiches. The sandwiches were not sold by weight or volume.
28. The price per gallon used in the audit was based on the average Midwest regional price per gallon because actual, accurate records were not available.
29. The auditor used the two-month sample to project the assessed sales tax liability into a four-year audit period, as explained below:

Merchandise sales that from the actual daily sales reports for the two-month sample were used to calculate their total merchandise sales. These amounts were then divided that by the gallons of gasoline that Petitioner purchased during the same period of time. This resulted in an approximate merchandise sales to gallon ratio. This ratio was then multiplied by the gallons purchased (per vendor invoices) for the rest of the audit period times the average Midwest price per gallon and that amount represented the calculated our merchandise sales for the entire audit period.

30. Gallons of fuel (gas and diesel) purchased were used because it represented the most stable amount available. Due to the fluctuations in price of gas, basing the ratio of gallons of fuel purchased to the amount of merchandise sold provided the best correlation, given the lack of reliable records.

CONCLUSIONS OF LAW

The three issues before the Tribunal are:

1. Whether the use of a two-month sample period, which was then projected to the entire 48-month audit period, was appropriate?
2. Whether the fact that three Audit Reports were issued (the original and two revisions) was appropriate?
3. Whether certain prepared foods made on Petitioner's premises should be subject to sales tax?

As to whether the use of a two-month sample period, which was then projected to the entire 48-month audit period, was appropriate, the applicable law is MCL 205.68(1); whereby Petitioner is required maintain adequate records. MCL 205.68(1) states, in part, "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."

MCL 205.68(4) further provides:

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.

The Court of Appeals in *Plum Hollow Market, Inc v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, issued October 16, 2012 (Docket No. 305505), pp 2-3, concluded:

. . . the Tribunal's determination that petitioner's record-keeping did not comply with MCL 205.67(1) [*now MCL 205.68(1)*] is supported by substantial evidence. The record demonstrates that respondent's auditor could not verify from petitioner's records if the proper amount of sales tax had been collected to satisfy the liability imposed on petitioner. Section 7(1) plainly provides that "[a] person liable for any tax imposed under this act shall keep . . . receipts." The Z-rings were the receipts of daily sales and should have been maintained.

* * *

If respondent determined that a taxpayer has failed to maintain proper records or has reason to believe the records provided are incomplete or inaccurate, MCL 205.67(1) [*now MCL 205.68(4)*] provided that it may assess sales tax owed "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."

This Court has approved the use of supplier invoices as the basis for an assessment in situations where the taxpayers did not maintain proper records. *Vomvolakis*, 145 Mich App at 244. Although that method has its limitations, this Court has held that "the Legislature has granted [respondent] wide discretion in the selection of auditing methods." *By Lo Oil Co v Dep't of Treasury*, 267 Mich App 19, 42, 703 NW2d 822 (2005). The fact that a particular audit method used is not the most reliable does not refute the prima facie correctness of the audit; a showing of actual inaccuracy in the result is required. *Id.*

The Tribunal concludes that, in accordance with MCL 205.68(4), Petitioner has failed to maintain or preserve proper records as prescribed by this section, and the Respondent has a strong basis for believing that any records maintained or

returns filed may be inaccurate or incomplete and that additional taxes are due. Therefore, it is appropriate for the department to assess the amount of the tax, interest, and penalty due based on information that was available or that became available to it. Respondent's assessment is considered prima facie correct.

Having established its prima facie case, as documented in its audit report and as confirmed by the testimony of Respondent's auditor, the burden shifts to Petitioner to refute Respondent's prima facie case. Petitioner has utterly failed to do so. It has provided no arguments that would raise any level of doubt as to the accuracy of Respondent's assessment, which the Tribunal concludes was based on the best information that was available or that became available to it. Therefore, the Tribunal must conclude that the findings in Respondent's final audit report accurately reflect Petitioner's sales tax liability.

As to whether the issuance of three Audit Reports (the original and two revisions) was appropriate, the Tribunal concludes that, based on the credible testimony of Respondent's auditor, Mr. Storey, the adjustments were the result of additional information provided for the most part by Petitioner and information that came to light after the original audit report had been completed, and any adjustments which resulted therefrom were appropriate to include as a part of the final audit report.

Regarding the issue of whether certain prepared foods made on Petitioner's premises should be subject to sales tax, when sold at retail by Petitioner, the Tribunal looks to Revenue Administrative Bulletin 2009-8, Approved: October 21, 2009, Sales Tax – Food for Human Consumption, which states, in pertinent part:

6. Delicatessens.

Food sold in an unheated state by weight or volume as a single item, without eating utensils, is not “prepared food” and is exempt from sales and use tax. Therefore, deli trays of such foods as cheese and crackers, luncheon meats, seafood, or vegetables and dip, sold in an unheated state by weight or volume as a single item, without eating utensils, are not subject to sales or use tax. [Emphasis added.]

Deli items sold at (or below) room temperature by weight or volume as a single item, without eating utensils, such as potato salad, coleslaw, sliced meats, and vegetables, regardless whether previously heated by the seller, are not “prepared food” and are not taxable.

Deli items sold at a temperature higher than room temperature, whether sold by weight or volume as a single item or sold without eating utensils, are “prepared food” and are subject to sales and use tax. This would include, for example, hot roasted or fried chicken, buffalo wings, ribs, etc.

7. Sandwiches.

A sandwich made by the seller (two or more food ingredients combined by the seller for sale as a single item) is “prepared food” and subject to sales and use tax, unless it is sold in an unheated state by weight or volume as a single item, without eating utensils. [Emphasis added.]

A sandwich that is not made by the seller, that is not sold in a heated state, and that is not sold with an eating utensil provided by the seller, is not “prepared food” and is not taxable. [Emphasis added.]

The Tribunal finds that the sandwiches prepared and sold by Petitioner, which were made from ingredients purchased from third-party vendors, and are not sold by weight or volume, meet the definition of prepared food, as provided by RAB 2009-8, and are, therefore, subject to sales tax when sold by Petitioner.

JUDGMENT

IT IS ORDERED that Petitioner's Sales Tax Assessment No. TH72122 for Tax Periods May 1, 2006, through April 30, 2010, is AFFIRMED.

IT IS FURTHER ORDERED that the officer charged with collecting or refunding the affected taxes, interest, and penalties shall collect the taxes, interest, and penalties or issue a refund as required by this Order within 28 days of the entry of this FOJ.

This FOJ resolves all pending claims in this matter and closes this case.

By: B.D. Copping

Entered: June 28, 2013