

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

Plum Hollow Market, Inc.,  
Petitioner,

v

MTT Docket No. 348020  
Assessment No. P986157

Department of Treasury,  
Respondent.

Tribunal Judge Presiding  
Cynthia J Knoll

FINAL OPINION AND JUDGMENT

INTRODUCTION

Plum Hollow Market, Inc. (Petitioner) appeals an assessment issued by the Michigan Department of Treasury (Respondent) of sales tax, plus interest and penalties. The assessment is the result of Respondent's audit which found Petitioner's records insufficient to audit sales. Instead, the audit was performed by conducting a sampling of products purchased and Petitioner's retail markups in order to determine the gross sales, both taxable and non-taxable. Petitioner disagrees with Respondent's methodology and calculations, contending that Respondent erroneously included certain purchase invoices as taxable prepared food. Despite some legitimate concerns over certain aspects of Respondent's approach to the audit, the Tribunal finds Petitioner has failed in its burden to refute the prima facie correctness of the assessment, and the assessment is affirmed.

BACKGROUND

Petitioner is a grocery store located in Southfield, Michigan. Respondent conducted a sales tax audit of the period July 1, 2004, through August 31, 2007. Respondent's auditor determined Petitioner had underpaid sales tax in the amount of \$17,387, based on her conclusion that Petitioner had overstated the non-taxable food deduction and understated its taxable sales. Respondent issued an Intent to Assess on April 30, 2008, and imposed a 10% negligence penalty because of Petitioner's failure to properly record purchase and sales figures. Petitioner requested and was granted an informal conference with Respondent's Hearing Division, which was held on November 3, 2008. The Hearing Referee found Respondent's audit determination to be correct

and recommended the Intent to Assess be assessed as originally issued. Accepting the Referee's recommendation, Respondent issued its Decision and Order of Determination on December 10, 2008, and Final Bill for Taxes Due (Final Assessment) P986157, for \$17,387.00 tax, \$1,740.00 penalty, and \$4,218.27 interest, as accrued through December 17, 2008.

On June 2, 2008, Petitioner filed this appeal with the Tax Tribunal contemporaneous with its request for informal conference with Respondent's Hearing Division, appealing the assessed tax, interest and penalty. A prehearing was held on November 8, 2010, and a Scheduling Order was issued setting forth February 10, 2011, as the final date for the parties to submit to the Tribunal all proposed exhibits, with specific instructions as to the proper submission. Not only did Petitioner submit its exhibits 7 days late, it failed to Bates stamp the documents as required. Nevertheless, Petitioner's evidence was admitted to the extent Respondent did not object. A hearing was held February 24, 2011.

#### PETITIONER'S CONTENTIONS:

Petitioner appeals the sales tax assessment noting "[t]he facts upon which petitioner relies as the basis for the proceeding herein . . . as follows:

- a. Wrong assessment period.
- b. Wrong gross sales and total deductions on audit compared to what was actually reported for 2006.
- c. Reported tax incorrect for 2006 on audit calculation.
- d. Disagree with methodology of determining tax deficiency, does not take fluctuation of inventory into account.
- e. Auditor determined that the only problem [was] unreported taxable purchases from Sam's Club, after it was determined that another company made these purchases, it appeared that the auditor took a difference approach to determine a tax deficiency.
- f. Food for human consumption and total deduction as reported do not agree with what audit determination shows as reported." Petitioner's petition, pp. 1 & 2.

Petitioner did not submit trial briefs; however, at hearing Petitioner's representative stated:

In the calculation that [Respondent's auditor] prepared to add what is called prepared foods back into the calculation, . . . we're challenging that because of the various things that are included in on these invoices are things that we consider not to be prepared foods. . . . Prepared foods are things that they actually prepare, like – basically, they have ribs and rotisserie chickens that they consider prepared foods. . . . Everything else they sell as a grocery store. . . . What we are trying to do is we're trying to take these invoices that we have out of her calculation. . . . That's pretty much it. . . . [T]hat involves a lot of things, like [a] deduction on the sales tax return that she changed that . . . we put in as a deduction as food for human consumption. . . . [S]o that's really the gist of that. So if we can . . . have these invoices taken out of her calculation, we would be happy with that. Transcript, pp. 5 - 7.

Petitioner submitted evidence in the form of Respondent's audit work papers with handwritten revisions allegedly reflecting Petitioner's assertion that none of the purchase invoices should be subject to tax. Petitioner's representative stated that he prepared the schedule however, he did not testify as to its authenticity as he was not called as a witness. He stated that “. . . when you take [the auditor's] formula and you take these prepared food items out that she put in, we actually show that we have a refund coming back for each one of these periods.” Transcript, p. 9.

Petitioner's owner, Mr. Bob Rinderknecht, testified to a number of the invoices considered by Respondent as purchases of prepared food. He stated that items such as frozen raw bread dough is thawed, baked and sold as a loaf of bread, and pies are baked and sold on the shelf. He testified that the pies are sold as a whole pie, and “the only time those would be sold in pieces is after a couple of days old, sometimes we cut them and we put some up on the register.” Transcript, p. 49. He stated that sales tax is charged for a single slice of pie. He also asserts that the one-pound packages of sausages are prepackaged, ready to be sold and Amish chicken is sold from the meat counter. Mr. Rinderknecht testified that they make potato salad, coleslaw and tuna salad that are sold from the deli by the pound. He further testified that they purchase four-pound bags of shredded cheese then put it in cups, which are sold out of the cheese case in the grocery department.

Mr. Rinderknecht testified that Petitioner purchases very little in the way of prepared foods. He testified that the display warming case from which prepared foods are sold is about

three feet by three feet in size, and it sits on top of the meat counter, whereas the store is approximately 5,000 square feet. He also stated that sandwiches are made-to-order and that they are rung-up as taxable deli. Transcript, p. 64. He stated:

“ . . . some of these invoices have some soup on them, because we used to buy some soup and mix it with our homemade soups. But . . . when you make homemade soup, we take some stew meat out of the meat counter or whatever and some produce out of the produce department and you make soup. When you cook chickens, you have to take some chickens out of the meat counter. . . . Or ribs out of the meat - - there’s not an invoice that comes in, . . . that’s specifically for the - - it’s a byproduct, in other words, of the store.” Transcript, p. 62.

Petitioner contends that when inventory is taken for use to make into prepared foods, they do not keep records of the items removed from inventory. However, Petitioner asserts that tax is always properly collect on taxable sales of prepared foods.

#### RESPONDENT’S CONTENTIONS

Respondent contends that the audit assessment is correct and that the primary cause of adjustment was due to an overstated food for human consumption deduction taken by Petitioner during the audit period. Respondent’s auditor found that Petitioner had two main cash registers with keys for departmental breakdown of deli, bakery, meat, taxable grocery, grocery, produce, and liquor. The keys that add sales tax were deli, taxable grocery, and liquor. The auditor found that Petitioner performs the following processes: i) z-rings the two cash registers daily, ii) records the sales amounts from the register tapes onto a daily sales sheet, and iii) discards the register tapes after they are recorded. She also found that taxable grocery and grocery totals are lumped together on the sales sheet prepared by Petitioner, and there is no distinction between the “other taxable sales” and “nontaxable sales.” She determined that Petitioner reports gross sales on the SUW (sales, use and withholding return) using the categories of grocery, meat, produce, bakery, prepared food, liquor, and sales tax. Petitioner does not distinguish between sales that are taxable and nontaxable. All sales are combined and sales tax is determined by the tax collected for the month according to the cash register tapes. Respondent contends that Petitioner determines its taxable sales based upon the amount of sales tax collected. She also found that the amount of sales tax collected was properly reported. Nevertheless, Respondent concluded that Petitioner’s records were inadequate and that Petitioner failed to properly accrue sales tax.

At hearing, Respondent's auditor testified: "I do not agree that the prepared foods . . . percentage should be zero." Transcript, p. 10. Respondent's attorney stated:

The problem is when the auditor goes in and has to look at supplier records, they have to go by the independent information they're given from the supplier. In the absence of records kept by the taxpayer, which [they] are required to keep by statute if they want to prove their case, then they have to look at the best available information they can get. That is the supplier invoices. . . . Without the Z rings to show what was actually sold as prepared food, and without any kind of records whatsoever of what was taken out of inventory and made into prepared food, the Department has to go by the information it can get, and that's the supplier information. So we know there was prepared food. We know that the Petitioner can offer no specific records about what was sold as prepared food. We've got to go back to the supplier and look at the invoices and say what on here looks like it probably was made into prepared food. Transcript, p. 25.

Respondent's auditor testified that the best available information upon which she could base the audit deficiency calculation was that provided by Petitioner, using the independent purchase invoices to determine the percents of purchases for their different categories, taxable and nontaxable. She agreed that as a general practice, she uses supplier information because it is the only information that is independent that the taxpayer has no control over. Transcript, p. 79. She further stated that she reviewed the purchase invoices from vendors that Petitioner indicated were prepared food vendors but that Petitioner did not provide any written documentation or evidence of any sort to show which purchases were used to make prepared foods. Transcript, p. 80.

In summary, Respondent contends that Petitioner failed to maintain adequate records and, as a result, the tax was correctly determined from available information and is prima facie correct. Petitioner has the burden of proof to come forward with positive proof of its taxable sales, as distinguished from the negative burden of disproving Respondent's computation.

#### FINDINGS OF FACT

Petitioner is engaged in a retail business and is generally required to collect and remit sales tax. Petitioner's sales consist of groceries, liquor, beer, and wine, and miscellaneous taxable merchandise. Petitioner sells prepared foods such as rotisserie chicken and barbeque ribs. Certain sales or receipts are specifically exempt from tax, including sales of food for human consumption. Respondent conducted an audit of Petitioner's business and determined that Petitioner's records were inadequate to effectively audit sales. Respondent therefore

employed an audit method to test understated purchases. Respondent also used a block sampling method, choosing with Petitioner to review the months of March and April, 2007.

Respondent's auditor prepared a purchase spread of Petitioner's original purchase invoices. Purchases for the test period were accounted for and the auditor determined there were no understated purchases. Based on her analysis, the auditor determined the food percentage was 84.058% after applying a categorical markup. Petitioner reported a food deduction of 89.9416%, 89.4024%, 89.1603% and 86.3393% for the tax periods 7/04 – 12/04, 2005, 2006 and 1/07 – 8/07 respectively.

The audit process included a review of taxpayer's records of sales. The auditor verified sales reported by Petitioner for federal income tax returns and on the SUW returns. She determined there were no differences in sales and the sales were accepted as reported on the SUW returns and no adjustment was made.

Petitioner's accountant informed the auditor that the taxable sales are backed into using the sales tax reported by Petitioner. He said he has no way to determine if the correct amount of sales tax was collected; however, the auditor stated that she found that the amount of sales tax collected was properly reported and remitted.

#### CONCLUSIONS OF LAW

The assessment at issue in this matter is for unpaid sales tax. 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. [emphasis added]

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

[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. MCL 205.51(1)(d).

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.

The statute requires that taxpayers 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.

In addition, the Michigan Administrative Code provides:

R 205.23 Records.

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.

(2) 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.

(3) 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.

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.

Respondent determined that the books and records provided to its auditor by Petitioner were inadequate and failed to meet the statutory requirements. Respondent therefore based its audit conclusions on what it believed to be the best information available, as is consistent with MCL 205.67 and *Vomvolakis v Department of Treasury*, 145 Mich App 238; 377 NW2d 309 (1984), which affirmed the Tribunal's determination that a state revenue auditor did not exceed his authority in basing sales tax assessments against the petitioner on supplier summaries, under the belief that the petitioner did not keep accurate or complete records. MCL 205.67 establishes that the ". . . 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 Tribunal in *Summerville v Department of Treasury*, MTT Docket No. 149724 (1994), stated that the "taxpayer must show that the assessments are improper, unlawful or inappropriate and what, if any, **is the correct and proper tax liability.**" Emphasis added.

This Tribunal, upon due, careful, and deliberate consideration of the entire record in this matter, concludes that Petitioner did not maintain complete and accurate records as required and that Respondent acted reasonably in its audit methodology basing its assessment upon the information that was available and obtainable. Although the Tribunal agrees with Petitioner that certain of Respondent's calculations and methodologies likely result in imperfect estimates and not exact tax determinations, Petitioner has failed in its burden to refute Respondent's prima

facie correct assessment and further failed to substantiate what the sales tax should be for the reasons set forth herein.

At the outset of the hearing, Petitioner testified that the values derived from the invoices utilized by Respondent's auditor in establishing the sales tax due should be taken out of the auditor's calculation. Petitioner further asserted that when these values are subtracted and the sales tax is recalculated accordingly, Petitioner is owed a refund; thus, Petitioner asserts its tax liability is zero. Transcript, pg. 9. Schedule D1 of Petitioner's admitted Exhibit C, Petitioner's Mark-up of Respondent's Audit, determines that the prepared foods amount is \$8,572.18. Petitioner testified that this value should be \$0 in that ". . . none of [the] invoices [utilized by Respondent] are actually prepared food invoices." Transcript, p. 22.

After questioning by the presiding Tribunal Judge, Petitioner's representative admitted that prepared foods are included in the invoices, "[b]ut not the whole invoice." Transcript, p. 22. In response, Respondent's auditor testified that:

[I]t's great to say, well, we didn't buy anything with the idea of it being a prepared food. So you can't look at the supplier invoices, because that won't tell you anything, because we didn't buy anything with the intent to be prepared food, we just got it in inventory. And now we've created prepared food. Transcript p. 25.

The Tribunal finds Petitioner's contentions and Petitioner's representative's statement contradictory and ultimately determines that prepared foods are included in Petitioner's invoices; thus, the prepared foods percentage is not zero. Accordingly, the Tribunal finds that Petitioner is liable for some amount of sales tax. The Tribunal's remaining task is to discern whether Petitioner has met its burden in refuting Respondent's assessment and establishing the correct and proper sales tax liability.

Petitioner's Exhibit C does not reconstruct Respondent's audit to substantiate its claims. Rather, Exhibit C is a mark-up of Respondent's audit where Petitioner crossed out and recalculated Respondent's auditor's numbers to back out the prepared foods, which changed the total of the deductions included by Respondent's auditor. Although Petitioner contends that backing out all of the invoices is appropriate, it had been determined that *some* portion of the products listed on Petitioner's invoices is prepared food. Petitioner has failed to prove by a preponderance of the evidence that *every* invoice should be deducted. Petitioner testified to various products listed in the numerous invoices utilized and identified whether or not those

foods were prepared. However, the Tribunal does not find that Petitioner met its burden to refute Respondent's assessment merely through the testimony provided. Petitioner presented no other evidence to establish that taxable sales were actually less than that which had been determined by Respondent. As such, the Tribunal cannot determine with any degree of certainty from the invoices provided by Petitioner at hearing, with no original business records, what, if any, modification should be made to Respondent's assessment.

Petitioner's owner testified that there are many products that are sold at retail grocery. However, he did not convincingly testify as to whether the sales tax was properly charged and remitted. Further, Respondent's auditor testified that, as a general practice, they use supplier information when performing an audit "because that is the only information that is independent that the taxpayer has no control over." Transcript, p. 79. Nevertheless, the Tribunal finds that Respondent overstepped its audit authority by taking purchase orders and assuming the entire amount was used for prepared foods. Despite the poor condition of Petitioner's record keeping, the Tribunal finds that Respondent's audit was not without its own inherent weaknesses. The statistical method employed, based on a block sample method, is acceptable and not considered biased. However, determining a sales tax that is statutorily based on gross sales price, by looking to the retailer's purchase price and applying a mark-up, seems to be an "upside-down" or inverted approach to an audit. The tax is imposed on sales price, not cost plus some arbitrary amount. Nevertheless, the courts have blessed the methodology because "a fair reading of the relevant statutes indicates that the Legislature intended to give the Department of Treasury power to base assessments on the best information that it could obtain." *Vomvolakis, supra*.

In sum, although Petitioner has raised doubt as to the accuracy of Respondent's assessment, Petitioner has not substantiated this claim with sufficient and reliable evidence or testimony to refute Respondent's prima facie correct assessment. Therefore, Respondent utilized the best available information to determine Petitioner's sales tax deficiency and the assessment is affirmed.

#### JUDGMENT

IT IS ORDERED that Assessment No. P986157 is AFFIRMED.

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

Entered: May 16, 2011

By: Cynthia J Knoll