Cite as Det. No. 15-0350, 35 WTD 291 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	DETERMINATION
	)	
	)	No. 15-0350
	)	
. . .	)	Registration No. . . .
	)	

[1] RULE 254; RCW 82.32.100; RETAIL SALES TAX – RETAILING B&O TAX – RECORDKEEPING – REASONABLE ESTIMATES. Reporting cash sales below 3% for a restaurant is itself indicative of underreporting cash sales which coupled with incomplete electronic business records supports the use of an estimated percentage of cash sales under RCW 82.32.100(1).

[2] RULE 254; RCW 82.32.100; RETAIL SALES TAX – RETAILING B&O TAX – RECORDKEEPING – REASONABLE ESTIMATES. An industry study on customer payment practices is a reasonable and acceptable source of facts and information to develop an estimated percentage of cash sales under RCW 82.32.100(1).

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Kreger, A.L.J. – A company operating a restaurant protests an assessment estimating unreported cash sales, asserting that the records provided were sufficient and all sales were reported. We affirm the assessment because the Audit Division has established that business records were insufficient and reasonably exercised its authority to arrive at an estimate of cash sales. We deny the Taxpayer's petition.[1]

ISSUES

1. Has a Taxpayer meet its obligation to maintain suitable records to establish tax liability under RCW 82.32.070 and WAC 458-20-254 when its business records indicate an unusually low amount of cash sales?

2. Pursuant to RCW 82.32.070 and .100, did the Department of Revenue abuse its discretion in determining that an estimate of cash sales was necessary, and was the estimate generated reasonable?

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

FINDINGS OF FACT

[Taxpayer] is a Washington corporation doing business as a restaurant that sells Mexican cuisine, liquor, beer, and wine in . . . , Washington. The Audit Division of the Department of Revenue (Department) conducted an audit of the Taxpayer's Washington business activities for the period of January 1, 2010 through March 31, 2014. The audit resulted in an assessment being issued for additional tax due in the amount of $ . . . .[2] The Taxpayer timely appealed the assessment contesting the need to estimate cash sales.

The audit assessed retail sales tax and retailing business and occupation (B&O) tax on mandatory service charges and tips, which the Taxpayer had not reported as part of the retail sales price of meals. However, the bulk of the retail sales tax and retailing B&O tax assessed was attributable to an estimate of unreported cash sales. Review of the business records available by the Audit Division showed an exceptionally low level of cash sales being reported, at about 2.66% of total sales.

Point of Sale (POS) records were not available for the first 11 months of the audit period, but the Taxpayer asserts that print outs of data from this period was available. The Taxpayer explained that information from their old POS system was not consistently available in an electronic format, but that paper records were available and provided to the auditor. The auditor also notes that the June 2012 report provided did not include breakdown detail on cash and non-cash payments. The data that was reviewed produced a cash sales estimate of 2.66% on average. The Taxpayer does not contest this cash sale percentage, but rather asserts that this low volume of cash sales is accurate noting that fewer customers are paying by cash.

The Taxpayer also notes that its cost of goods is in the expected range of 30% to 33% throughout the audit period, which it emphasizes for that the Internal Revenue Service (IRS) details as 34.5% for moderately-priced full service restaurant in its Market Segment Specialization Program. The Taxpayer also notes that this cost of goods percentage is also in line with that the National Restaurant Association details as normal in its Restaurant Operations Report.

The Taxpayer disputes the conclusion that cash sales were underreported and contests that the Audit Division did not support its need to estimate cash sales. Specifically, asserting that the Audit Division did not give due weight to the cost of goods sold information and asserting that the Audit Division has failed to establish that the records provided were insufficient.

ANALYSIS

RCW 82.32.070 provides:

> (1) Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include

[2] The Assessment Document No. . . . , was comprised of $ . . . in retail sales tax, $ . . . in retailing business and occupation (B&O) tax, $ . . . in use tax, interest of $ . . . and a penalty of $ . . . for misuse of a resale certificate or reseller permit (assessed on $ . . . in purchases).

> copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue.

See also WAC 458-20-254 (Rule 254); Det. No. 99-341, 20 WTD 343 (2001).

If a person fails to keep and preserve suitable records, then RCW 82.32.100 provides:

> (1) If any person fails or refuses to make any return or to make available for examination the records required by this chapter, the department shall proceed, in such manner as it may deem best, to obtain facts and information on which to base its estimate of the tax; and to this end the department may examine the records of any such person as provided in RCW 82.32.110.

In this case, the business records indicated an underreporting of cash sales. Electronic records were unavailable for the initial months of the audit period and review of the records provided showed a cash sales percentage just below 3%. The Taxpayer is asserting that this percentage is accurate and correct and there is no basis to estimate cash sales. However, such a low percentage of cash sales is an indication that cash sales are being underreported.

In reviewing business records, the Audit Division expects to see a certain volume of cash sales based on the type of business at issue and the normal range of sales for this type of business. This expected level of cash sales is based on general experience gained through auditing comparable businesses and also supported by two specific industry studies addressing consumer payment patterns. Specifically, the Audit Division relies on a 2008 industry study, prepared by First Data and a 2010 study prepared by Hitachi Consulting, which detail average cash purchase percentages for different categories of merchants making retail sales.[3] The 2008 industry study details that electronic payments are growing across all surveyed retail locations, but also notes that payment methods vary between retailers. Restaurant's cash sales on average range between 30% to 66% of their total sales, with fast food type restaurants at the high end of that range. Thus, fast food restaurants with a comparatively lower per sale average cost average 66% cash sales, and consumers tendency to use electronic payments methods increases in correlation with the average total meal cost as one moves along the spectrum to full service restaurants. The 2010 study results are similar, indicating average cash payments averages of 55% at fast food restaurants, 33% at coffee shops, and 27% cash payments at restaurants.

The Taxpayer's restaurant is not a fast food establishment but a casual dining restaurant offering a lunch and dinner. Thus, the expected cash sales percentage may arguably fall to the lower end of the spectrum. In this case, the Audit Division used a 20% estimate of cash sales, which is below the average for all of the restaurants at issue in the studies.

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[3] First Date Corporation – 2008 Market Brief study on Consumer Payment Preferences for In-Store Purchases. First Data is a credit card processing company and conducted this nationwide study in 2008. 2010 BAI & Hitachi Study of Consumer Payment Preferences, dated January 25, 2011.

In the 2010, study the merchant with the lowest cash sales was Department Stores and those stores still had 14% cash sales.[4] Similarly, the 2008 study also identifies Department Stores as the type of merchant with the lowest level of cash sales and even that type of retailer still had a 15% average for cash sales.[5] We agree with the Taxpayer that fewer customers are electing to pay in cash, however, the cash sales percentage that is reflected in the available business records is not only not reasonable for a comparable restaurant but is materially lower than the expected range of cash sales for any type of retail merchant.

We disagree with the Taxpayer's assertion that a 3% cash sale average is reasonable, and therefore, also disagree with the asserting that such a low percentage of cash sales could be accurate for the type of restaurant business at issue here. Rather, we concur with the Audit Division that this percentage of cash sales is itself indicative of underreporting of cash sales. Therefore, we conclude Audit Division correctly concluded that the available business records were not suitable and did not accurately reflect business income from cash sales.

The Taxpayer also takes issue with the thoroughness of the audit and asserts that the cost of goods information provided was not given due weight. The Audit Division confirms that the costs of good detail provided was reviewed and considered, but this information does not resolve or address the extremely low volume of cash sales. Noting that just as the low volume of cash sales supports an inference that cash sales are not being reported, it is also possible that cash was being used to purchase goods and not recorded or reflected in the detail produced.

We have previously noted and affirmed the Department's authority to assess taxes based on a reasonable estimate. *See* Det. No. 14-0106, 33 WTD 402 (2014); Det. No. 13-0302R, 33 WTD 572 (2014); Det. No. 03-0279, 23 WTD 252 (2004); Det. No. 97-134R, 18 WTD 163 (1999). We also note that the authority granted to the Department to make estimates of tax liability is similar to the discretion afforded the IRS in generating assessments of tax liability. In addressing the similar authority of the IRS to estimate, the United Stated Supreme Court has stated:

> [G]ranting the IRS assessment authority, must simultaneously grant the IRS power to decide how to make that assessment-at least within certain limits. And the courts have consistently held that those limits are not exceeded when the IRS estimates an individual's tax liability-as long as the method used to make the estimate is a "reasonable" one. . . . .

[4] In addition to the types of merchants detailed above, the 2010 study shows grocery stores with 19% cash sales, drug stores with 25% cash sales, discount/warehouse stores with 20% cash sales, gas stations with 22% cash sales, cinema with 36% cash sales, and transit with 15% cash sales.

[5] The types of retail locations addressed in the 2008 survey and their cash sales percentages included: Department Store - 15%, Discount Store – 20% , Grocery Store - 21%, Gas/Convenience Store – 24%, Drug Store - 26%, Restaurant – 30%, Cinema/Theatre - 59%, Transit – 64%, and Fast Food 66%.

United States v. Fior D'Italia, Inc., 536 U.S. 238, 243, 122 S.Ct. 2117, 153 L.Ed.2d 280 (2002). [6] As to the thoroughness of the audit process, the auditor reviewed: the federal income tax returns, the excise tax returns filed, the system reports provided, the depreciation schedules, capital asset and consumable supply purchases, invoices and receipts provided, use tax work-papers, and credit card statements. The information provided by the Taxpayer made it difficult to determine the gross income of the business. We find no evidence that the audit process at issue was not through, or support for the assertion that specific records were not considered. The fact that the Taxpayer disagrees with the result of the audit does not independently indicate that the records provided were not considered and reviewed.

We also disagree with the Taxpayers assertion that the information available was complete and accurate. The detail that was available and which was analyzed resulted in a cash sales percentage below 3%. The Taxpayer does not dispute this percentage as the amount of cash sales that were reported. This volume of cash sales is not credible for a business like the Taxpayer's and as noted above, indicates that cash sales were underreported. We concur with the Audit Division that such a low volume of cash sales is itself evidence that cash sales are not being fully reported. Furthermore, we note that the estimate used by the Audit Division is not just at the low end of the average estimates of cash sales for restaurants but below that range at 20%.

We conclude that the Audit Division correctly determined that the business records provided indicated an underreporting of cash sales, which provided the authority to estimate those sales. We find no evidence that the Audit Division abused its discretion in determining the need to estimate cash sales or that it acted unreasonably in generating that estimate. We affirm the adjusted assessment and deny the Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 22nd day of December, 2015.

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[6] The court goes on to detail a variety of instances when an estimate of tax liability was reasonable and also addresses the range of information that can provide a reasonable basis for the estimate:

> *See, e.g., Erickson v. Commissioner,* 937 F.2d 1548, 1551 (C.A.10 1991) (estimate made with reference to taxpayer's purchasing record was "presumptively correct" when based on "reasonable foundation"). *See also Janis*, supra, at 437, 96 S.Ct. 3021 (upholding estimate of tax liability over 77-day period made by extrapolating information based on gross proceeds from 5-day period); *Dodge v. Commissioner*, 981 F.2d 350, 353-354 (C.A.8 1992) (upholding estimate using bank deposits by taxpayer); *Pollard v. Commissioner*, 786 F.2d 1063, 1066 (C.A.11 1986) (upholding estimate using statistical tables reflecting cost of living where taxpayer lived); *Gerardo v. Commissioner*, 552 F.2d 549, 551-552 (C.A.3 1977) (upholding estimate using extrapolation of income over 1-year period based on gross receipts from two days); *Mendelson v. Commissioner*, 305 F.2d 519, 521-522 (C.A.7 1962) (upholding estimate of waitress' tip income based on restaurant's gross receipts and average tips earned by all waitresses employed by restaurant); *McQuatters v. Commissioner*, 32 TCM 1122, 1973 WL 2419 (1973), ¶ 73,240 P-H Memo TC (same)