

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Sales and Use)
Tax for the period November 1, 1993 through)
September 30, 1996 by the Secretary of)
Revenue)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2000-134

This matter was heard before the former Assistant Secretary of Revenue, Mr. Michael A. Hannah, in the City of Raleigh, on October 31, 2000, upon application for hearing by the Taxpayer wherein he protested a proposed assessment of tax, penalty, and interest for the period November 1, 1993 through September 30, 1996. The hearing was held by the Assistant Secretary pursuant to G.S. 105-260.1. The Taxpayer attended the hearing and was represented by [an attorney] and [an accountant]. The Sales and Use Tax Division was represented by Mr. W. Timothy Holmes, Assistant Director and William C. Shelton, Administration Officer. The final decision was rendered by Mr. Eugene J. Cella, the current Assistant Secretary of Revenue.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Proposed Assessment on December 9, 1996 to the Taxpayer assessing tax, penalty, and interest totaling \$122,828.28 for the above period. The Taxpayer filed a timely protest to the proposed assessment and requested a hearing before the Secretary of Revenue.

ISSUE

The issue to be decided in this matter is as follows:

Is the assessment correct and properly proposed to be assessed against the Taxpayer based on the best information available?

EVIDENCE

The following items were introduced into evidence by the parties.

1. Memorandum dated August 20, 1999, from the Secretary of Revenue to the Assistant Secretary of Revenue, designated Exhibit E-1.

2. Copy of the Taxpayer's Application for Sales and Use Tax Registration and Annual Wholesale License, Form E-504, dated July 3, 1991, designated Exhibit E-2.
3. Face sheet of audit report dated November 15, 1996 and explanation of changes dated November 15, 1996, designated Exhibit E-3.
4. Notice of Sales and Use - Audit Tax Assessment dated December 9, 1996, designated Exhibit E-4.
5. Letter dated December 18, 1996, from the Taxpayer's attorney to the Sales and Use Tax Division (Division), designated Exhibit E-5.
6. Letter dated December 23, 1996, from the Taxpayer's attorney to the Division, designated Exhibit E-6.
7. Letter dated January 8, 1997, from the Division to the Taxpayer's attorney, designated Exhibit E-7.
8. Letter dated February 14, 1997, from the Personal Taxes Division to the Taxpayer's attorney, designated Exhibit E-8.
9. Letter dated July 17, 1997, from the Revenue Field Audit Supervisor to the Taxpayer's attorney, designated Exhibit E-9.
10. Letter dated July 18, 1997, from the Taxpayer's attorney to the Revenue Field Audit Supervisor, designated Exhibit E-10.
11. Copy of Subpoena to Testify Before Grand Jury dated August 22, 1997, to the Revenue Field Audit Supervisor, designated Exhibit E-11.
12. Letter dated November 26, 1997, from the Taxpayer to the Division, designated Exhibit E-12.
13. Transcript of discussion dated November 28, 1997, between the Taxpayer, Taxpayer's accountant, accountant's associate, Taxpayer's attorney, Revenue Field Audit Supervisor and examining auditor, designated Exhibit E-13.
14. Letter dated December 9, 1997, from the Division to the Taxpayer, designated Exhibit E-14.
15. Letter dated December 12, 1997, from the Taxpayer's attorney to the Revenue Field Audit Supervisor, designated Exhibit E-15.
16. Letter dated December 15, 1997, from the Taxpayer to the Division, designated Exhibit E-16.
17. Letter dated January 5, 1998, from the Division to the Taxpayer, designated Exhibit E-17.
18. Letter dated January 12, 1998, from the Taxpayer to the Secretary of Revenue and the Division, designated Exhibit E-18.

19. Letter dated February 4, 1998, from the Division to the Taxpayer, designated Exhibit E-19.
20. Letter dated February 5, 1998, from the Taxpayer to the Secretary of Revenue and the Division, designated Exhibit E-20.
21. Letter dated February 13, 1998, from the Taxpayer to the Secretary of Revenue and the Division, designated Exhibit E-21.
22. Letter dated February 26, 1998, from examining auditor to the Taxpayer's attorney, designated Exhibit E-22.
23. Letter dated March 2, 1998, from the examining auditor to the Taxpayer's attorney, designated Exhibit E-23.
24. Letter dated March 30, 1998, from the Taxpayer's attorney to the Division, designated Exhibit E-24.
25. Letter dated March 30, 1998, from the Taxpayer to the Secretary of Revenue and the Division, designated Exhibit E-25.
26. Letter dated May 1, 1998, from the Division to the Taxpayer's attorney, designated Exhibit E-26.
27. Letter dated December 13, 1999, from the Division to the Taxpayer's attorney, designated Exhibit E-27.
28. Letter dated March 24, 2000, from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-28.
29. Letter dated May 24, 2000, from the Taxpayer's attorney to the Assistant Secretary of Revenue, designated Exhibit E-29.
30. Letter dated May 25, 2000, from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-30.
31. Letter dated July 25, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-31.
32. Letter dated August 3, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-32.
33. Statements and daily sales summaries presented at the hearing for various periods from January 11, 1999 through April 28, 2000, designated Exhibit T-1.
34. Information and tobacco sales summaries explaining the buy down program by cigarette manufacturers for February, April, and May, 2000 presented at the hearing, designated Exhibit T-2.

35. Letter dated November 1, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-1
36. Memorandum dated November 3, 2000 from the Division to the Revenue Field Auditor Supervisor, designated Exhibit E-33.
37. Letter and attached affidavits dated November 13, 2000 from the Taxpayer's attorney to the Assistant Secretary of Revenue, designated Exhibit T-3.
38. Letter dated November 16, 2000 and the attached affidavit by the Revenue Field Auditor Supervisor dated November 13, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-2.
39. Letter dated November 28, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-3.
40. Letter dated December 5, 2000 from the Taxpayer's attorney to the Assistant Secretary of Revenue, designated Exhibit T-4.
41. Letter dated December 6, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-4.
42. Letter dated December 12, 2000 and the attached supplemental affidavit by the Revenue Field Auditor Supervisor dated December 11, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-5.
43. Letter dated December 18, 2000 from the Taxpayer's attorney to the Assistant Secretary of Revenue, designated Exhibit T-5.
44. Letter dated December 27, 2000 from the Taxpayer's attorney to the Assistant Secretary of Revenue, designated Exhibit T-6.
45. Letter dated December 29, 2000 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-6.
46. Letter dated April 18, 2001 from the Acting Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-7.
47. Letter dated July 26, 2001 from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit S-8.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. The Taxpayer operates convenience stores making both retail and wholesale sales.

2. Cash deposits into the Taxpayer's bank accounts greatly exceed and do not reconcile with the amounts reported on the Taxpayer's sales and use tax returns and individual income tax returns for the audit period.
3. The Department's auditors used indirect means to establish the Taxpayer's taxable sales for the audit period.
4. The Department has allowed beneficial adjustments in the audit report for all properly documented cigarette manufacturer "buy down funds", gasoline sales, and wholesale sales.
5. The Taxpayer's sales records, which include daily sales summaries for the audit period, were in the custody of the United States Department of the Treasury, Bureau of Alcohol, Tobacco and Firearms until provided to the Assistant Secretary on May 22, 2001. These partial records are not necessarily exculpatory since they do not explain cash deposits which greatly exceed the amount reported on sales and income tax returns.
6. The daily sales summaries and letters from tobacco manufacturers and gasoline wholesalers presented at the hearing are for periods outside the audit period.
7. The Taxpayer did not provide any information at the hearing to overcome the presumption of correctness of the proposed assessment.

CONCLUSIONS OF LAW

Based upon the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. The Taxpayer was at all material times, a retailer and wholesaler engaged in the business of making sales of taxable and non-taxable tangible personal property.
2. A retailer is required to keep suitable records of the gross receipts of sales of a business and any other books or accounts which may be necessary to determine the amount of tax for which the retailer is liable pursuant to G.S. 105-164.22.
3. All gross receipts of wholesale merchants and retailers are subject to the retail sales tax until the contrary is established by proper records pursuant to G.S. 105-164.26.
4. An assessment of tax is presumed to be correct and the burden is upon a taxpayer who takes exception to an assessment to overcome that presumption pursuant to G.S. 105-241.1(a).
5. The Taxpayer provided no evidence, written or otherwise, to contradict the assessment or overcome the presumption of correctness.
6. A Notice of proposed assessment for the period was properly issued to the Taxpayer pursuant to G.S. 105-241.1.

DECISION

The Taxpayer is engaged in the business of operating retail convenience stores and also operates as a wholesale distributor of cigarettes. The Department examined the Taxpayer's records and discovered that there was a significant discrepancy between the total money deposited into the Taxpayer's bank accounts and the taxable and non-taxable sales reported on the Taxpayer's monthly sales and use tax returns and individual income tax returns. G.S. 105-241.1(a) provides that if the Secretary is unable to obtain from a taxpayer adequate and reliable information on which to base an assessment, then an assessment can be based on the best information available and the assessment shall be deemed correct and furthermore that an assessment of tax is presumed to be correct. Based on this statute and considering the discrepancy between taxable and non-taxable sales reported and the deposits made to the Taxpayer's bank accounts, the examining auditors used the indirect means to establish the Taxpayer's correct taxable and non-taxable sales.

The Taxpayer contends that the bank deposit and cash paid out method used by the examining auditors to compute its taxable sales overstates the amount of taxable receipts attributable to sales of tangible personal property. He contends that the receipts derived from sales were at least partially explained by non-taxable sales of gasoline or non-taxable funds received from cigarette manufacturers as part of "the buy down" programs offered to retailers by cigarette manufacturers. The auditors adjusted the amount of taxable and non-taxable sales reported on the Taxpayer's 1994 and 1995 Schedule C of the Taxpayer's individual income tax returns using a source and application of funds methodology. The auditors allowed an adjustment for the cigarette manufacturer "buy down funds" which were verified through 1099s furnished by the Taxpayer. Adjustments were also made to gross sales based on the Taxpayer's nontaxable gasoline sales as determined using gasoline purchases increased by the markup. All documented non-taxable wholesale sales, which were primarily cigarette sales, were likewise allowed as a deduction from taxable sales. The adjusted 1994 and 1995 sales

figures were used to determine the percentage (33.39%) of sales under-reported which was applied to the taxable sales reported for the audit period.

The Taxpayer furnished sales summaries, computed by the Taxpayer, and letters from tobacco manufacturers and gasoline distributors in further support of his contentions. The aforementioned records are for various periods from January, 1999 through May, 2000 (Exhibits T-1 and T-2) all of which are outside the audit period. Similar records for the audit period had been subpoenaed and were in the custody of the United States Treasury, Bureau of Alcohol, Tobacco and Firearms (Exhibit E-11) until some of the records were provided to me on May 22, 2001. This documentation is not necessarily exculpatory. Even if complete documentation were available, the Taxpayer would still be obligated to resolve the problem of cash bank deposits greatly exceeding reported taxable sales and gross sales reported on his sales and use tax returns and individual income tax returns.

G.S. 105-164.22 provides that a retailer is required to keep suitable records of the gross receipts of sales of a business and any other books or accounts which may be necessary to determine the amount of tax for which the retailer is liable. G.S. 105-164.26 provides that all gross receipts of wholesale merchants and retailers are subject to the retail sales tax until the contrary is established by proper records. The auditors reviewed all records which were provided for the audit period, including many of the daily sales summaries prepared by the Taxpayer. The auditors determined that the summaries and records which support the monthly sales and use tax returns were not accurate due to deposits into the Taxpayer's bank accounts not reconciling with income tax returns and taxable and nontaxable sales reported. The Taxpayer's argument fails since he has been unable to show that the miscellaneous 1999 and 2000 monthly records provided at the hearing demonstrate that the Department's methodology is flawed or that the Department should rely solely on the Taxpayer's records, the accuracy of which is in question.

The information presented at the hearing is not sufficient to overcome the presumption of correctness of an assessment which is set forth in G.S. 105-241.1(a) because the information that was provided at the hearing (Exhibits T-1 & T-2) covers periods which are outside the audit period. The additional information provided on May 22, 2001 does not address the large discrepancy between cash receipts during the audit period and the sales summaries for the same period. Therefore, the assessment of tax, penalty, and interest is deemed to be correct under the law and facts, and is hereby sustained. The proposed assessment is hereby declared to be finally determined and immediately due and collectible together with penalty and interest as allowed by law.

Made and entered this 29th day of August, 2001.

Signature _____

Eugene J. Cella
Assistant Secretary of Revenue