

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 February 1, 1998 through )  
December 31, 2001, by the Secretary of )  
Revenue of North Carolina )  
vs. )  
[Taxpayer] )

**FINAL DECISION**  
Docket No. 2002-98

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on May 8, 2002, upon application for hearing by the Taxpayer wherein it protested the proposed assessment of tax, penalty, and interest for the period February 1, 1998 through December 31, 2000. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Richard C. Stewart, Administration Officer. The Taxpayer was represented by [an attorney], [the principal stockholder], [another stockholder], and [the manager].

The Taxpayer is a corporation engaged in business as an adult nightclub making retail sales of alcoholic beverages. On February 9, 2001, an auditor with the Department completed an examination of the Taxpayer's records. The additional tax assessed resulted from the Taxpayer underreporting sales of beer and mixed drinks on its monthly sales and use tax returns.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment to the Taxpayer on February 21, 2001 assessing tax, penalty, and interest in the amount of \$20,409.35. The Taxpayer's attorney, on behalf of the Taxpayer, objected to the assessment in a letter dated March 7, 2001 and timely 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 against the Taxpayer and based on the best information available?

## EVIDENCE

The Sales and Use Tax Division presented the following items into evidence:

1. Copy of memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated Exhibit E-1.
2. Copy of face sheet of audit report and auditor's comments dated February 9, 2001, designated Exhibit E-2.
3. Copy of the Notice of Sales and Use Tax Assessment dated February 21, 2001, designated Exhibit E-3.
4. Copy of letter dated March 7, 2001 with attachments from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-4.
5. Copy of letter dated April 2, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-5.
6. Copy of letter dated April 6, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-6.
7. Copy of letter dated April 25, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-7.
8. Copy of letter dated June 4, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-8.
9. Copy of letter dated June 7, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-9.
10. Copy of letter dated June 20, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-10.
11. Copy of letter dated June 29, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division and attachments, designated Exhibit E-11.
12. Copy of letter dated July 13, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-12.
13. Copy of letter dated July 17, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division and attached affidavit from an employee of the Taxpayer dated July 30, 2001, designated Exhibit E-13.
14. Copy of letter dated August 21, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-14.
15. Copy of letter dated September 12, 2001 from the Taxpayer's attorney to the Revenue Field Auditor and attached power of attorney dated September 10, 2001, designated Exhibit E-15.

16. Copy of letter dated September 25, 2001 from the Taxpayer's attorney to the Revenue Field Auditor, designated Exhibit E-16.
17. Copy of letter dated November 9, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-17.
18. Copy of letter dated November 20, 2001 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-18.
19. Copy of letter dated November 28, 2001 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-19.
20. Copy of Appendix 5B from an Internal Revenue Service publication, designated Exhibit E-20.
21. Copy of Schedule E-2 of the Sales and Use Tax audit report titled Additional Taxable Sales Analysis, designated Exhibit E-21.
22. Copy of letter dated January 18, 2002, from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-22.
23. Copy of letter dated February 12, 2002, from the Assistant Secretary of Revenue to the Taxpayer's attorney, designated Exhibit E-23.
24. Copy of Brief for Tax Hearing, prepared by the Sales and Use Tax Division, designated Exhibit E-24.

The following evidence was presented by the Taxpayer's attorney at the hearing:

25. Copy of affidavit from [Taxpayer's former manager], designated Exhibit TP-1.
26. Copy of brief for tax hearing presented by the Taxpayer's attorney, designated Exhibit TP-2.
27. Copy of affidavit from [Taxpayer's current manager], designated Exhibit TP-3.

### **FINDINGS OF FACT**

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

1. The Taxpayer was engaged in business making retail sales of alcoholic beverages during the audit period.
2. Guidelines issued by the Internal Revenue Service provide that the 750 milliliter bottles purchased by the Taxpayer should yield between 16.9 and 33.9 drinks per bottle of liquor. The Department used a figure of 20 drinks per bottle to compute the sales tax liability on sales of mixed drinks.

3. To determine the Taxpayer's retail sales of liquor, the total number of bottles of liquor purchased, based on records maintained by the North Carolina Alcoholic Beverage Commission, were multiplied by the number of drinks per bottle, times the average sales price of mixed drinks. The Taxpayer testified that mixed drinks sold for between \$4.75 and \$6.50 each. The Department used a figure of \$5.00 per mixed drink to compute the sales tax liability.
4. To determine the Taxpayer's retail sales of beer, the total number of bottles of beer sold, based on the Taxpayer's purchase records, was multiplied by the average sales price per bottle of beer. The Taxpayer testified that beer sold for between \$2.75 and \$3.75 a bottle. A figure of \$3.00 was used as the average sales price per bottle in computing the tax liability.
5. The Department assessed sales tax on the Taxpayer's additional sales of beer and mixed drinks.
6. The Notice of Sales and Use Tax Assessment was mailed to the Taxpayer on February 21, 2001.
7. The Taxpayer protested the assessment and timely requested a hearing before the Secretary of Revenue.

#### **CONCLUSIONS OF LAW**

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

1. The Taxpayer was a retailer and at all material times engaged in the business of making retail sales of beer and mixed drinks subject to sales tax.
2. The Taxpayer did not keep suitable records of sales of tangible personal property as required in G.S. 105-164.22.
3. The assessment was based on the best information available.
4. A proposed assessment is presumed to be correct.
5. The burden is upon a taxpayer who takes exception to an assessment to overcome that presumption.
6. The evidence presented by the Taxpayer was not sufficient to overcome the presumption of correctness.
7. The Notice of Proposed Assessment for the period of February 1, 1998 through December 31, 2001 was issued pursuant to G.S. 105-241.1.

## DECISION

The Taxpayer operates as an adult nightclub and makes retail sales of alcoholic beverages. The examining auditors, in comparing the Taxpayer's purchase records to taxable sales reported, determined that the Taxpayer was substantially understating and underpaying its sales tax liability on monthly sales and use tax returns. The Taxpayer did not keep suitable records of sales of beer and alcoholic beverages as required in G.S. 105-164.22 and the Department, pursuant to G.S. 105-164.24, was obligated to prepare an assessment of additional tax, penalty, and interest due based on the best information available.

In order to determine the Taxpayer's sales tax liability, the Department proposed to assess additional tax on the number of bottles of beer and mixed drinks sold by the Taxpayer multiplied by the respective sales price. As the Taxpayer's records were not reliable, the auditor used records obtained from beer distributors and the local Alcoholic Beverage Control Board to determine the total purchases of bottles of beer and liquor by the Taxpayer. The Taxpayer advised the auditors that the average price of a mixed drink sold by the Taxpayer was between \$4.75 and \$6.50. In calculating the tax liability for the sales of mixed drinks, the auditors used a figure of \$5.00. The Taxpayer stated that the average sales price for a bottle of beer was between \$2.75 and \$3.75 and a figure of \$3.00 was used to calculate the sales of beer. The Taxpayer does not object to the \$5.00 figure used as the average sales price for mixed drinks, nor does the Taxpayer object to the sales tax liability assessed on sales of beer. The Taxpayer's objection centers on the number of mixed drinks poured from each bottle of liquor and on the Department's alleged failure to account for pilferage and breakage in determining the total sales of mixed drinks.

The Taxpayer, in support of its objection, produced affidavits from a former manager of the business and an officer of the corporation stating that, considering the pilferage, breakage, and strong drinks poured by the Taxpayer's bartenders, that a figure of 10 drinks per bottle was more accurate. The Taxpayer's current manager provided an affidavit and testified that she

believed the bottles yielded between 10 and 15 drinks. The Taxpayer also produced an affidavit from a patron, stating that he has observed the bartenders pouring drinks at the Taxpayer's business and believes that the drinks prepared by the Taxpayer's bartenders contain more than the standard "shot" of alcohol.

Guidelines published by the Internal Revenue Service provide that the 750 milliliter bottles purchased by the Taxpayer should yield between 16.9 and 33.9 mixed drinks. The Department used a figure of 20 drinks per bottle in computing the tax liability. The Department contends that it used figures of 20 drinks per bottle and a sales price of \$5.00 per mixed drink, figures well short of the midpoint in the ranges, to account for the pilferage and breakage and drinks provided without charge to patrons.

The statutes require a retailer to maintain suitable records to determine the sales of the business and absent suitable records the Secretary is allowed to base an assessment of tax on the best information available. In using an average cost per drink of \$5.00 from a range of \$4.75 to \$6.50 and an average of 20 drinks per bottle from a range of 16.9 to 33.9 taken from Internal Revenue guidelines, I find the Department has produced a reasonable formula to calculate the Taxpayer's liability for sales of mixed drinks. I also find that the method of using purchase records and an average cost of \$3.00 per bottle to calculate sales of beer is reasonable. Under G.S. 105-241.1, an assessment of the Secretary of Revenue is presumed to be correct and it is incumbent on a Taxpayer who objects to the assessment to overcome the presumption of correctness.

In the case of the former manager and officer of the corporation and the current manager, the testimony did not contain any quantifiable data that could reasonably be termed factual evidence. In both cases, the observations of the affiants are qualified with the term "I believe" and offer only observations and nothing in the way of facts. The affidavit of the patron, who claims to have observed the Taxpayer's bartenders pouring drinks and claims to frequent like establishments in [another area of the State], offers only ineffectual supposition and does

little to bolster the Taxpayer's objections. The Taxpayer clearly failed to maintain the records required by G.S. 105-164.22. To accept at face value self-serving affidavits of supposition from employees and former employees of the corporation would undermine the intent of the statute.

I find, therefore, that the Taxpayer has provided no additional information upon which to base an amendment to the assessment and has not met its burden of overcoming the presumption of correctness of the assessment. The proposed assessment of tax, penalty, and interest is deemed correct under the law and the facts and is hereby sustained.

Wherefore the assessment is sustained in its entirety, and is declared to be final and immediately due and collectible.

This 24<sup>th</sup> day of June, 2002.

Signature \_\_\_\_\_

Eugene J. Cella  
Assistant Secretary of Administrative Tax Hearings