

**STATE OF ARKANSAS  
DEPARTMENT OF FINANCE AND ADMINISTRATION  
OFFICE OF HEARINGS & APPEALS**

**ADMINISTRATIVE DECISION**

**IN THE MATTER OF**

**ACCT. NO.:** [REDACTED]

**GROSS RECEIPTS AND  
COMPENSATING USE  
TAX ASSESSMENTS**

**DOCKET NOS.: 20-588**

**(\$ [REDACTED] – Sales Tax)<sup>1</sup>**

**20-589**

**(\$ [REDACTED] – Use Tax)<sup>2</sup>**

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**RAY HOWARD, ADMINISTRATIVE LAW JUDGE**

**APPEARANCES**

This case is before the Office of Hearings and Appeals upon a written protest submitted on December 12, 2019, and signed by [REDACTED], Attorney at Law, [REDACTED] (“Taxpayer’s Representative”), on behalf of [REDACTED], the Taxpayer. The Taxpayer protested the assessments of gross receipts tax (“sales tax”) and compensating use tax (“use tax”) resulting from an audit conducted by Rhonda Whittle (“Tax Auditor”), from the Southwest Audit District<sup>3</sup> of the Office of Field Audit, for the Department of Finance and Administration (“Department”). The audit period was from September 1, 2013, through July 31, 2019 (Audit ID: [REDACTED]).

A telephone hearing<sup>4</sup> was held in Little Rock, Arkansas, on August 6, 2020, at 10:00 a.m. The Department was represented by Nina Carter, Attorney

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<sup>1</sup> The assessed amount includes tax ([REDACTED]), penalty ([REDACTED]), and interest ([REDACTED]).

<sup>2</sup> The assessed amount includes tax ([REDACTED]) and interest ([REDACTED]). The assessment for use tax was not protested.

<sup>3</sup> This is now the Southern Audit District.

<sup>4</sup> All participants appeared via telephone.

at Law, Office of Revenue Legal Counsel (“Department’s Representative”). Present for the Department were the Tax Auditor, Paula Osbourn – Audit Supervisor, and Melissa Guin – Audit District Manager.

The Taxpayer was represented by Taxpayer’s Representative. Present for the Taxpayer was [REDACTED] – Owner, [REDACTED] – Employee BM, [REDACTED] – Employee BG, and [REDACTED] - Employee JY (collectively, “Taxpayer’s Employees”) and [REDACTED] – [REDACTED]. (“Marketing Consultant”).

Post-hearing submissions filed by the parties will be addressed in the Conclusions of Law portion of this Administrative Decision.

### **ISSUE**

Whether the assessments issued by the Department against the Taxpayer should be sustained? Yes.

### **FINDINGS OF FACT/CONTENTIONS OF THE PARTIES**

The Department’s Answers to Information Request summarized the facts and issued involved in this case (including the basis for the Taxpayer’s disagreement with the assessments as reflected in the handwritten portion of the Protest Form submitted by the Taxpayer’s Representative) and stated, in part:

[REDACTED] (“Taxpayer”) is a restaurant located in [REDACTED] inside the city limits of [REDACTED]. The business operates as an S-Corp and opened on [REDACTED]. [REDACTED] is the sole owner of the business. From April 29, 2019, Southwest Audit District Auditor, Rhonda Whittle, conducted a routine audit on behalf of the Department for tax period January 1, 2016, through July 31, 2019.

The Auditor confirmed the scheduled gross receipts and compensating use tax audit appointment with the Taxpayer by letter dated April 29, 2019. See **Exhibit 1**. The Auditor advised

Taxpayer to provide all accounting records, with fifteen specific categories of records listed in the attached schedule, and any other records used by the Taxpayer to prepare tax records or financial statements from April 1, 2016, through March 31, 2019.

On May 8, 2019, the Auditor met with [REDACTED] CPA for Taxpayer, and began a review of the available records. The records provided included credit card statements and bank statements. Prior to the audit appointment, the CPA advised that Taxpayer did not keep cash register receipts, Z-tapes, or any other documentation to support its sales. The practice had been that Taxpayer would provide the CPA's office with a taxable sales amount to remit each month without supporting documentation and the CPA would list that amount in QuickBooks for purposes of sales tax and corporate income tax reporting. A review of the bank statements indicated that Taxpayer only deposited enough cash to cover payroll checks that were being cashed for employees out of the cash register.

The Auditor was later provided with z-tapes for May 1, 2019, through August 19, 2019, and some purchase records from vendors. The purchase records indicated showed incidents of Taxpayer purchasing more food items than reported as taxable sales. Taxpayer also paid food vendors, utilities, and other routine expenses in cash. The Auditor reported errors in matching the z-tapes to the bank statements and found that credit card transactions were not being processed through the register. The z-tapes also contained errors showing amounts of taxable sales on some days that were unrealistic for the restaurant. It was determined that Taxpayer was underreported by greater than 25% during the current 3 years. As a result, the Auditor extended the audit period back to September 1, 2013.

Upon review of the available food purchase records for April 1, 2016, through July 31, 2019, the Auditor determined that, due to the lack of adequate records, an alternate method would be required to complete the audit. See Schedule A-5, attached as **Exhibit 2**. The Auditor then offered the CPA two options for completing the audit, either a markup of food purchases based on menu prices or a markup using an agreed profit margin of approximately 40%, which calculates to a 70% over cost markup. The Taxpayer agreed to use the 70% above cost markup. The actual sales figures from Schedule A-5 were then used to determine the markup. See Schedule A-4, attached as **Exhibit 3**.

Because Taxpayer was unable to provide all of the purchase records for the extended audit period, a projection was used for that part of the audit. A total of [REDACTED] was calculated for the markup on

the 40-month[Footnote 1 stated that, “Actual number of months reported and calculated was 37, but the monthly average was still determined by dividing by 40, which benefits Taxpayer as a discount of over [REDACTED]/month.”] period of actual sales. See Schedule A-5, attached as **Exhibit 2**. The Auditor divided [REDACTED] by 40 to arrive at a monthly average rate of [REDACTED]. This average rate was used for the missing 31 months to calculate a projected taxable sales amount of [REDACTED]. See Schedule A-3, attached as **Exhibit 4**.

The Auditor compiled the reported taxable sales, marked up projected taxable sales, and marked up actual taxable sales and determined that Taxpayer was underreported on taxable sales in the amount of [REDACTED]. See Schedule A-2 and Schedule A, attached as **Exhibit 5**.

The audit resulted in the assessment of sales tax for under reported taxable sales and use tax for purchases that tax was not charged or remitted. The Summary of Findings and Basis for Adjustment was prepared on September 25, 2019 and delivered to the CPA on October 4, 2019.

See Summary of Findings, attached as **Exhibit 6**. . . .

[Table omitted]

. . .

A copy of the Protest is attached as **Exhibit 7**. It appears that the compensating use portion of the assessment is not in protest and only the sales tax portion of the assessment is at issue. It also appears that [REDACTED] on behalf of the Taxpayer, is claiming now that the calculation of estimated sales based on a markup was not reasonable although [REDACTED] agreed to this markup. [REDACTED] also agrees that Taxpayer failed to keep accurate records and that the Department has the authority to make an estimation of sales when adequate information is not available. No documentation or proof has been provided to demonstrate that the Department’s calculations were not reasonable.

. . .

In this case, Taxpayer did not submit sufficient sales records to complete the audit. Consequently, the Department estimated the Taxpayers remaining gross sales amounts utilizing an agreed upon markup.

In his letter of Protest, Taxpayer's CPA now claims that the calculation based on the [REDACTED] markup was not reasonable. This argument is not well taken. In fact, [REDACTED] was given options on how to complete the audit based on the lack of sufficient records. [REDACTED] agreed on the option to use the [REDACTED] markup and had an opportunity to debate the findings of the audit prior to the assessment. Moreover, [REDACTED] was sent a copy of the schedules on September 4, 2019, and no objection was made to any of the findings of the Audit. After the Auditor received no response or request for review, she finalized the findings of the Audit and then sent a Summary of Findings to [REDACTED]. [REDACTED] signed off on the Summary of Findings on October 7, 2019.

The Department made an assessment of sales tax based upon the best information and documentation available. [REDACTED] agrees that Taxpayer failed to keep adequate records. The burden of refuting the assessment is on the Taxpayer. As stated previously, the Taxpayer has not provided any evidence to demonstrate that the estimated assessment of tax by the Department is unreasonable. Accordingly, the sales tax assessment herein should be sustained in full.

The Taxpayer failed to maintain adequate business records and significant underreporting of tax liability was established, thus, a negligence penalty was also properly assessed against the Taxpayer under Ark. Code Ann. § 26-18-208(4)(A) (Supp. 2019). [P. 1 – 6].

The Tax Auditor presented testimony consistent with the contentions in the Department's Answers to Information Request and also testified that: (1) on April 29, 2019, she began a routine audit (sales and use tax) involving the Taxpayer; (2) Department Exhibit 1 is the appointment letter that she mailed to the Owner; (3) Page 2 of Department Exhibit 1 reflects a list of the accounting records requested by the Department for the audit; (4) on May 8, 2019, she met with the Taxpayer's Representative and began her review of available records; (5) the requested records that were provided were credit card statements and bank statements; (6) prior to the audit appointment, the Taxpayer's Representative advised her that the Taxpayer did not keep cash register receipts ("Z-tapes") or

any other documents that supported sales; (7) the Taxpayer would provide the Taxpayer's Representative with a taxable sales amount for the purpose of reporting and remitting monthly sales taxes but there was no supporting documentation; (8) a review of the bank statements indicated that the Taxpayer was only depositing enough money to cover payroll checks that were being cashed for employees out of the cash register; (9) ultimately, she was provided Z-tapes for the period of May 1, 2019, through August 19, 2019, and some food purchase records from vendors; (10) the food purchase records indicated that the Taxpayer was purchasing more food items than the Taxpayer was reporting as taxable sales; (11) the Taxpayer paid food vendors and other routine expenses with cash; (12) she determined there were errors when matching the Z-tapes to bank statements and found that credit card transactions were not being processed through the cash register; (13) the Z-tapes also contained errors showing taxable sales amounts on Sundays that were unrealistic for the Taxpayer's business; (14) after reviewing the records that were provided, she concluded that the Taxpayer was underreported by more than 25% so the audit period had to be extended back to September 1, 2013; (15) Department Exhibit 2 is a schedule showing detailed food purchases based on the records that were provided to her; (16) after reviewing the records relating to food purchases from April of 2016 through July of 2019, she determined that due to a lack of adequate records an alternative method would be required to complete the audit; (17) she offered the Taxpayer's Representative two [2] options for the alternative method, a markup of food purchases based on menu prices or a markup using an agreed upon profit margin of approximately [REDACTED] (which calculates to a [REDACTED] over cost

markup); (18) the Taxpayer's Representative agreed to the [REDACTED] above cost markup; (19) Department Exhibit 3 reflects the estimated monthly sales using the markup of [REDACTED] above the cost of food purchases; (20) she determined an average for monthly sales (\$ [REDACTED] ) from Department Exhibit 3 to be applied to months in the extended audit with no purchase records available (See Department Exhibit 4); (21) after compiling all of the projected taxable sales data, she determined that the Taxpayer was underreported for the six-year audit period in the amount of \$ [REDACTED] (See Department Exhibit 5); (22) Department Exhibit 6 is a Summary of Findings and reflects a sales tax assessment including tax, penalty, and interest; (23) she assessed the negligence penalty because the Taxpayer failed to maintain adequate records and a significant underreporting of tax liability was established; (24) Taxpayer's Representative completed the Taxpayer's Protest Form (See Department Exhibit 7); (25) it appears that the use tax assessment was not protested; (26) Taxpayer's Representative is now claiming that the calculation of estimated sales based on a markup was not reasonable even though he previously agreed to the markup;<sup>5</sup> (27) Taxpayer's Representative agreed that the Taxpayer failed to keep adequate records; and (28) no documentation or proof has been offered by the Taxpayer to demonstrate that the Department's calculations were not reasonable.

Upon cross-examination, the Tax Auditor testified that: (1) she toured the Taxpayer's place of business in [REDACTED]; (2) she is not sure about the population

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<sup>5</sup> During the cross-examination of the Tax Auditor, the Taxpayer's Representative stated that he did agree to doing a calculation of the gross but it was his understanding that the [REDACTED] markup would not include waste or charitable giving. The [REDACTED] was supposed to be on the actual product going out the door but not on the paper products.

of [REDACTED];<sup>6</sup> (3) she has not met the Owner; (4) to make the calculations, she used amounts from the check register because that is what was available (the amounts of payments in the check register were listed as costs and the markup was applied to those amounts); (5) she received information from the Taxpayer's Representative after the audit was completed about non-food items/paper goods purchased from a vendor (See Taxpayer Hearing Exhibit 1 – P. 5); (6) with respect to the paper goods, she advised the Taxpayer's Representative that if the audit was re-worked the assessment would still be substantial, and since he would still not be satisfied, it would be best to protest the assessment;<sup>7</sup> (7) with respect to the Taxpayer's contention concerning application of the [REDACTED] markup to non-food items, the assessment has not been adjusted at this point;<sup>8</sup> (8) she received a summary from the Taxpayer's Representative after the audit was closed;<sup>9</sup> (9) the Taxpayer had \$ [REDACTED] in reported sales over the six-year audit period; (10) she emailed her schedules to the Taxpayer's Representative

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<sup>6</sup> At this point, the Taxpayer's Representative stated that it is [REDACTED] and declining.

<sup>7</sup> At this point, the Taxpayer's Representative stated that: (1) the Tax Auditor told him to bring it up on appeal and that is what he is doing now; (2) [REDACTED] of the items purchased from the vendor at issue were non-food items; (3) all facts and circumstances should be considered in an audit; (4) he agreed with the Tax Auditor that sales should be estimated because the amounts were not as accurate as he wanted them to be; and (5) the estimated assessment came out on top of this world.

<sup>8</sup> At this point, the Department's Representative stated that: (1) she does not understand why none of this documentation was submitted with the protest; and (2) if these were things that the Taxpayer's Representative questioned, she does not understand why, after all of the months since the audit, the documents have been submitted and an adjustment is being requested.

<sup>9</sup> At this point, the Department's Representative stated that: (1) it was not reviewed in conjunction with the protest so she was not aware of any of this documentation; (2) she made it clear in her Answers to Information Request that she had not seen anything to support an adjustment of the audit; (3) to her, all of this documentation is new and she does not think it is appropriate for all of this documentation to be submitted at the time of the hearing; (4) this is not the appropriate place for the auditors to be reviewing documents; and (5) the auditors need time to review documentation like this and to consider it.



before the audit was completed and never received a response;<sup>10</sup> (11) the audit was completed and delivered a month after she emailed the schedules to the Taxpayer's Representative; (12) there are invoices listed on the document submitted by the Taxpayer's Representative that were not picked up in the audit<sup>11</sup> so the amount purchased from that vendor in February, as reflected on the document submitted by the Taxpayer's Representative, is higher than the amount she attributed to that vendor for purchases in February; (13) she never received all of the invoices from the Taxpayer's vendors so that is the reason the markup percentage was applied to payments to the vendors; (14) donations are taxable as withdrawals from stock; and (15) the information provided by the Taxpayer regarding waste is from 2020 so she is not sure how the information would be used for the audit period ending on July 31, 2019.<sup>12</sup>

The Audit Supervisor testified that: (1) with respect to the issue involving non-food items/paper goods the Taxpayer purchased from a vendor (approximately ■■■ of the items purchased in January and February of 2019 – See Taxpayer Hearing Exhibit 1 – P. 5), it has a bearing on the markup percentage used; (2) if the Taxpayer does not separate its paper supplies in calculating cost of goods sold on its corporate return (which was the basis for

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<sup>10</sup> The Taxpayer's Representative stated that: (1) he told the Tax Auditor that they needed to talk; (2) he received sheets of paper with a lot of calculations and the numbers seemed to come out of left field; and (3) he does not think the law provides that an audit can only be challenged during the time of the audit.

<sup>11</sup> At this point, the Taxpayer's Representative stated that he finds that hard to believe.

<sup>12</sup> At this point, the Taxpayer's Representative stated that: (1) it is reoccurring like business records; (2) the Department audited for 3 years and applied it back for the 6 year audit so this is the same thing; (3) the business has not changed; (4) he agrees that the Taxpayer was not keeping records of waste; (5) the Taxpayer is keeping much better records now; (6) the information is being presented as an example in order to make a more accurate estimate of what the Taxpayer's sales were during the audit period; and (7) he did not have any numbers for waste until after the audit was completed.

coming up with the markup percentage), then it has no bearing on whether the paper supplies were calculated in the markup;<sup>13</sup> (3) the Taxpayer's profit margin according to the 2018 return it filed was [REDACTED] and the Taxpayer's profit margin according to the 2017 return it filed was [REDACTED] so the [REDACTED] markup applied in the audit was reasonable;<sup>14</sup> (4) in 2015, the Taxpayer's profit margin was [REDACTED]; (5) when a markup is computed and it is applied to determine the gross receipts an item sold for, while withdrawals from stock may be affected, but tax-paid purchases of paper goods does not affect the markup percentage used in the overall audit because there is no deduction for paper goods when the markup percentage is calculated; (6) consumables (like paper plates) are included in the Taxpayer's cost of goods sold on its corporate income tax returns so those items were included in the cost when the markup percentage was calculated (the markup percentage was in line the markup percentage on other tax returns); (7) in determining the markup percentage the Taxpayer's cost of goods sold was used and analyzed against the cost of goods sold on tax returns, we did not calculate the markup percentage based just on the cost of meat, and it will always include consumables that tax was paid on; and (8) the gross receipts on corporate tax returns is going to match the taxable sales for sales tax (the only reason it would not is tax exempt sales).

With respect to the issue involving waste, the Audit District Manager stated that she thought the parties needed to agree on a percentage of waste. The Audit Supervisor then stated that: (1) the issue at hand is going to be coming up

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<sup>13</sup> At this point, the Taxpayer's Representative stated that is not how the markup was calculated, the markup was just set at [REDACTED] and he did agree to a [REDACTED] markup percentage on sales.

<sup>14</sup> At this point, the Taxpayer's Representative stated that those calculations are brand new and that is not where the [REDACTED] markup came from.

with figures to compare to actual costs; (2) based on what the Taxpayer's Representative has given the Department, the only months that would be considered are January and February and she would need to have the Taxpayer's total food cost for those months so a percentage for waste could be calculated; (3) she does not think that starting in March the Department would have an accurate waste figure because everything changed in March of 2020; and (4) before the Department could agree on a percentage of waste, the Taxpayer will have to produce documentation to establish the cost of goods sold in the months of January and February.<sup>15</sup> The Tax Auditor stated that the parties would try to reach an agreement regarding waste and documentation will be reviewed after it is received.

With respect to the issue involving food donations or contributions, the Audit Supervisor stated that those are taxable transactions but an adjustment could be made to assess at cost rather than retail value. The Audit District Manager stated that an adjustment would be made to the assessment if the correct documentation is provided. The Taxpayer's Representative stated that calculating the amount of the giveaways is not an easy calculation. The Tax Auditor stated that the parties would try to reach an agreement regarding withdrawals from stock and documentation will be reviewed after it is received.

The Department's Representative contended that: (1) the Department issued an estimated assessment against the Taxpayer because the Taxpayer failed to maintain suitable records; (2) the information the Taxpayer is submitting

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<sup>15</sup> The Taxpayer's Representative stated that he could furnish the information to the Department within a week from the hearing date but he might not include paper products and the auditors would review the information during the week following receipt.

concerning waste in 2020 did not exist during the audit period; and (3) the food given away by the Taxpayer should be include in taxable sales.

The Taxpayer's Representative submitted a Protest Form on behalf of the Taxpayer which set forth the following contentions:

The Taxpayer failed to keep accurate records. The Director made an estimate of sales based on purchases. A [REDACTED] markup was chosen without testing. Supplies were included in markup. There was no provision for waste . . . and charitable donation of food. This restaurant is in [REDACTED]. Seating capacity is [REDACTED]. There is a nice take out business.

The Director calculated sales of over [REDACTED] during the audit period. The Director is fully authorized to calculate sales from the best information available. This calculation must be reasonable. [P. 1].

Employee BG testified that: (1) she has worked up front at the register and at the drive-through window on and off for [REDACTED]; (2) the business is a [REDACTED] that seats about [REDACTED] people; (3) she would work when needed (such as lunch rush); (4) pre-Covid, the lunch rush was about [REDACTED] at the drive-through window; (5) [REDACTED] were sold the most; (6) a [REDACTED] was sold for [REDACTED] a [REDACTED] was sold for [REDACTED] (7) a [REDACTED] was [REDACTED] and a [REDACTED] was [REDACTED]; (8) she does not know the cost of making the [REDACTED]; (9) she would also work when [REDACTED] were sold; and (10) at the end of the day, leftover [REDACTED], and [REDACTED] are thrown away (nothing is reused from the day before).

Employee JY testified that: (1) he runs the [REDACTED] for the Taxpayer; (2) with [REDACTED], [REDACTED]<sup>16</sup>

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<sup>16</sup> Upon cross-examination, he stated that: (1) this could last for 2 or 3 weeks but it depends on the volume of sales; (2) it can also be frozen and used but, if it gets freezer burned, it is thrown away; and (3) he does not know the Taxpayer's cost for the [REDACTED]

so there was [REDACTED] of weight lost; (3) with [REDACTED], [REDACTED]  
[REDACTED] ([REDACTED]  
[REDACTED]); (4) over a 6-year period, a lot is lost; (5) he also cooks steaks [REDACTED]  
(this has been temporarily discontinued); (6) [REDACTED] is sold for [REDACTED]; (7)  
[REDACTED]; and (8) [REDACTED]  
[REDACTED]

The Marketing Consultant testified that: (1) for about 5 years, he has worked for the Taxpayer's main food provider as a sales consultant ; (2) until a few months ago, the Taxpayer's main food provider was the vendor identified on pages 5, 8, and 9 of Taxpayer's Hearing Exhibit 1; (3) the Taxpayer sells a [REDACTED] soft drink for [REDACTED] (other places price them at around \$[REDACTED]); (4) the Taxpayer sells a [REDACTED] (the same as a [REDACTED] so [REDACTED] is not being calculated in the price and other places price them at around [REDACTED]); (5) pages 6 and 7 of Taxpayer's Hearing Exhibit 1 depict the Taxpayer's old menu and pages 19 – 23 depict the Taxpayer's new menu; (6) the old menu priced a [REDACTED] and that was insane since the Taxpayer's cost was a minimum of [REDACTED]; (7) the Taxpayer buys a [REDACTED] and about [REDACTED] is lost immediately because [REDACTED]; (8) the [REDACTED] [REDACTED] so the weight varies for the advertised [REDACTED]; (9) the Taxpayer's [REDACTED] [REDACTED]<sup>17</sup> changes on a weekly basis [REDACTED]) so the Taxpayer should have "Market" on the menu instead of [REDACTED]; (10) when he started working with the Taxpayer a few months ago, the Taxpayer needed help with the

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<sup>17</sup> [REDACTED].

old menu prices ( [REDACTED] for a soft drink was not enough); (11) food prices increase around 4% per year on average; (12) the Taxpayer's cost of goods this year is about 12% higher than 3 years ago; (13) it would be reasonable to discount the cost of goods sold over a 6-year audit period; (14) the Taxpayer had other pricing issues such as [REDACTED]; (15) other restaurants he works with charge significantly more than the Taxpayer; and (16) the Taxpayer's markup is a lot less than other restaurants.

Employee BM testified that: (1) for [REDACTED] she has worked for the Taxpayer at the register, waiting tables, and at the drive-through window; (2) a lot of waste goes out the door ([REDACTED] are thrown away and about [REDACTED] per week a customer does not pick up an order so it is thrown away); and (3) the Taxpayer does charitable work [REDACTED] [REDACTED]

The Owner testified that: (1) she began operating the restaurant in [REDACTED]; (2) she does not keep good records; (3) the money is counted for daily sales and that is used for reporting sales tax; (4) every now and then she makes cash payments for some things; (5) she has been out of the restaurant for the last 2 or 3 years dealing with personal issues; (6) she now has a POS system and she is going to keep better books; (7) she is just trying to make a living; (8) she is [REDACTED]; (9) each time [REDACTED], she sends [REDACTED]; (10) she knows that her prices are cheap but she did not realize that she threw that much stuff away; (11) recently, she [REDACTED] [REDACTED] and was not paid anything; (12) she also [REDACTED]; and (13) she does not know what the auditors are talking about when they talk about withdrawing inventory.

The Taxpayer's Representative contended that: (1) whenever the Tax Auditor finished the audit, she handed it to him and he said it was hilarious since it was for ██████████ in ██████████ Arkansas; (2) the Tax Auditor turned around and walked out; (3) he did not have a chance to do anything; (4) he gave the Tax Auditor the calculation related to the paper supplies and she said to do it later on; (5) he has other objections to the audit; (6) he is sorry that he did not forward the documents to the Department's Representative; (7) there was no negotiation to include paper goods, spoilage, or shrinkage in the ██████████ mark up percentage; (8) he objects to anyone saying there was an opportunity to present certain information earlier; (9) if there is waste there is no sale for purposes of the gross receipts tax; (10) the Taxpayer made donations of food; (11) a lot of things were talked about during the audit because the records were not good; (12) the food donated by the Taxpayer should not be included in taxable sales; (13) Taxpayer pays sales tax at the time of purchasing paper goods;<sup>18</sup> (14) single checks were written out to vendors during the audit period that could have included the purchases of paper goods; (15) the Tax Auditor could see sales tax paid on paper goods as well as him but it was ignored so that is why he is saying the Department's estimate is not good; (16) the Department's method of calculation without removing the tax-paid purchases of paper goods means the Taxpayer is paying sales tax twice on those items;<sup>19</sup> (17) the Department's position is that the inclusion of paper goods in the assessment calculation is not

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<sup>18</sup> At this point, the Tax Auditor stated that she saw very few invoices so she could not confirm or deny this contention but she is aware that some vendors do charge tax on paper products that are not sold for resale.

<sup>19</sup> At this point, the Audit Supervisor stated that the Taxpayer was not selling paper plates but rather those items are consumables.

relevant but the paper goods are included with the amount of sales and included in the calculation of the amount of sales tax owed so the inclusion of paper goods in the assessment calculation is very relevant; (18) he and the Tax Auditor did not talk about using a markup percentage based on tax returns, the [REDACTED] markup percentage was arbitrary; (19) evidence has been introduced regarding the low prices charged by the Taxpayer for food items, that gives some indication that perhaps the [REDACTED] markup percentage may be off a little bit; (20) evidence was also introduced that for the entire menu the percentage is off somewhat; (21) this is not the most profitable business around; (22) to be told that the standard is the Taxpayer is exactly the opposite of what the evidence indicates; and (23) the whole hearing today is about reasonableness

## **CONCLUSIONS OF LAW**

### **Standard of Proof**

Ark. Code Ann. § 26-18-313(c) (Repl. 2020) provides, in pertinent part, as follows:

The burden of proof applied to matters of fact and evidence, whether placed on the taxpayer or the state in controversies regarding the application of a state tax law shall be by preponderance of the evidence.

A preponderance of the evidence means the greater weight of the evidence.

Chandler v. Baker, 16 Ark. App. 253, 700 S.W.2d 378 (1985). In Edmisten v. Bull Shoals Landing, 2014 Ark. 89, at 12-13, 432 S.W.3d 25, 33, the Arkansas Supreme

Court explained:

A preponderance of the evidence is “not necessarily established by the greater number of witnesses testifying to a fact but by evidence that has the most convincing force; superior evidentiary weight that, though not sufficient to free the mind wholly from all



reasonable doubt, is still sufficient to incline a fair and impartial mind to one side of the issue rather than the other.

The Department bears the burden of proving that the tax law applies to an item or service sought to be taxed, and a taxpayer bears the burden of proving entitlement to a tax exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(d) (Repl. 2020).

Statutes imposing a tax or providing a tax exemption, deduction, or credit must be reasonably and strictly construed in limitation of their application, giving the words their plain and ordinary meaning. Ark. Code Ann. § 26-18-313(a), (b), and (e) (Repl. 2020).

If a well-founded doubt exists with respect to the application of a statute imposing a tax or providing a tax exemption, deduction, or credit, the doubt must be resolved against the application of the tax, exemption, deduction, or credit. Ark. Code Ann. § 26-18-313(f)(2) (Repl. 2020).

### **Sales Tax Assessment<sup>20</sup>**

*Taxability.* Subject to the applicability of an exemption, deduction, or a credit, sales tax is imposed on sales of tangible personal property or taxable services made by in-state vendors/sellers to in-state purchasers.<sup>21</sup> Ark. Code Ann. § 26-52-103(35)(A) (Repl. 2020) defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses.” Prepared foods, food, and food ingredients are items of taxable tangible personal property. See Ark. Code Ann. § 26-52-317 (Repl. 2020) and Gross Receipts Tax Rule 2007-3 (“Special Rules for

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<sup>20</sup> The use tax assessment was not protested and has not been addressed.

<sup>21</sup> See Ark. Code Ann. § 26-52-101 et seq. (Repl. 2020).

Sales of Food and Food Ingredients and Prepared Food”). Consequently, the Department satisfied its burden of proof regarding taxability.

*Estimated Sales Tax Liability.* The liability for collecting and reporting sales tax is upon the seller of the tangible personal property unless the purchaser claims an exemption. See Arkansas Gross Receipts Tax Rule GR-79(C). Ark. Code Ann. § 26-18-506 (Repl. 2020) requires the Taxpayer to maintain suitable records and states:

(a) It is the duty of every taxpayer required to make a return of any tax due under any state tax law to keep and preserve suitable records as are necessary to determine the amount of tax due or to prove the accuracy of any return.

...

(d) When a taxpayer fails to preserve and maintain the records required by any state tax law, the director may, in his or her discretion, make **an estimated assessment** based upon information available to him or her as to the amount of tax due by the taxpayer. **The burden of proof of refuting this estimated assessment is upon the taxpayer.** [Emphasis added].

In the absence of suitable records, the Taxpayer has the burden of refuting the Department’s estimated assessment. See Jones v. Ragland, 293 Ark. 320, 737 S.W.2d 641 (1987); Leathers v. A. & B. Dirt Movers, Inc., 311 Ark. 320, 844 S.W.2d 314 (1992); Weiss v. Best Enterprises, Inc., 323 Ark. 712, 917 S.W.2d 543 (1996). The law requires that sufficient credible evidence be offered by the Taxpayer to establish that the audit results are unreasonable.

In Leathers v. A & B Dirt Movers, Inc., 311 Ark. 320, 844 S.W.2d 314 (1992), the Arkansas Supreme Court discussed the absence of appropriate documentation in the context of an estimated assessment, and stated:

In short, we find Mr. Nabholz’s testimony insufficient, standing alone, to meet the taxpayer’s statutory burden in refuting the

reasonableness of the assessment. To hold otherwise would be to permit a taxpayer to maintain scant records and after an unsatisfactory tax audit, avoid taxation by merely verbalizing his transactions unsupported by appropriate documentation made at the time of the transactions or by testimony from other parties to the transactions.

Id. at 330, 844 S.W.2d at 319.

The Taxpayer's Representative submitted the Taxpayer's initial post-hearing submission on August 21, 2020, and stated as follows:

Background:

██████████ is located on ██████████ just as you enter the ██████████ City limits. A city of approximately ██████████ and losing population. It is one of ██████████ in the town as listed in Wikipedia. It sits a ██████████ in ██████████ (see pictures). The sitting area is less than ██████████. The owner is ██████████. She is ██████████. She and her husband, ██████████, started the restaurant ██████████. She is not so much of a business person. Her point of sale register broke down years ago and her reports for sales tax purposes have been audited and found wanting.

Commissioner May Estimate Assessment Based on Available Information. -- Ark. Stat. Ann. § 84-1907 (Repl. 1980) requires the taxpayer to keep suitable records for tax purposes, and, if a taxpayer fails to keep suitable records, the Commissioner of Revenues may make an estimated assessment based on the available information. [Ark. Stat. Ann. § 84-4711(d) (Repl. 1980).] Cohan v Commissioner [39 F2d 540(2d Cir. 1930)] gives the principle that such calculation must take into account the facts and circumstances surrounding the calculation and that such calculation should be reasonable.

The checks made out to food venders were totaled and a 70% markup was applied to calculate taxable sales in the state calculations.

THE MARKUP %

██████████ gave testimony at the hearing which was held August 6, 2020, that the markup for menu items at ██████████ is low compared with standards. Specifically the menu lists ██████████. Menus from ██████████ in the area have been obtained: The

██████████; and ██████████. There are not a lot of comparables in the area. Both these restaurants have been established for ██████████ years and have a good reputations and similar menu items to ██████████. They get their food from the same suppliers as does ██████████ as ██████████ can attest to. Copies of the menus are attached and I have prepared a summary of the menu costs. There should be expected some variances in pricing but you would expect similar pricing given that the markup on the food items is expected to be a standard amount. The circumstances find the pricing between ██████████ and The ██████████ to be very similar. They leave ██████████ behind. A table has been prepared illustrating these findings. The perspective menus have been scanned and sent in the file marked "Menus". ██████████ mark up is well below what you would expect it to be and is calculated at approximately ██████████ of the cost to eat at these ██████████. A calculated markup of about half of The ██████████. We respectfully ask a lower markup of ██████████ be used to calculate the markup at ██████████ This is approximately half the calculated difference between the pricing comparison between ██████████.

#### PAPER GOODS

The markup for the sales tax audit was chosen at ██████████ which gives a food cost of approximately ██████████ of sales. Paper goods are a regular purchase for the taxpayer and are purchased through her food venders for the best pricing. The cost of these goods is considered a part of cost of goods sold by the auditor. Paper products are not marked up for sale and should be removed to calculate taxable sales. Many of these purchases have already had sales tax paid. Invoices from the taxpayer's venders have been provided to the auditor for review during the initial audit. Paper goods account for roughly ██████████ of her total purchases from these venders in a month. Please see attached ██████████ to see this analysis of ██████████ invoices for January & February 2019 showing the breakdown of food versus nonfood purchases. Please see "Jan & Feb 2020 Invoices vs Sales vs Waste" for a breakdown of the purchases from ██████████ for January and February 2020 showing an increase of the purchases in her invoices that are nonfood. ██████████ has also sent information on this breakdown which was sent previously.

#### WASTE

██████████ is known for ██████████. All ██████████. Even ██████████ start fresh every day. There is waste on a daily basis. Much of this waste is food that is cooked that

cannot be kept and still keep the same quality. Sales were computed based on costs of goods sold which would include these products that have not been sold and therefore should not be included in sales. The taxpayer started keeping a good records of waste in 2020. The compiled information is attached as "Jan Feb 2020 Waste Transcript". Copies of the original information should be attached as "Waste Originals". February is missing ten days that are prorated. The total waste for February is [REDACTED]. The total waste for January is calculated at [REDACTED]. We respectfully request the taxable sales be reduced for this waste as computed for January as the lower and more reliable figure.

#### SHRINKAGE

Testimony was also given on shrinkage of meat items due to cooking and removing of fat. It can be significant and reduce the return on sales. No calculation as to how it effects the markup has been made on this issue.

#### CHARITABLE GIVING

The taxpayer firmly believes in giving back to the community. These are food items she purchases and prepares without any compensation for giving to the community. They do not produce cash sales subject to sales tax. Supporting documentation was submitted at the hearing as to the volume of this giving. The giving has been substantiated. [REDACTED] was contacted to give the retail value of her giving. A breakdown is submitted as "Charitable Giving Analysis" attached. We respectfully ask this amount of [REDACTED] per year be removed from taxable sales.

#### MISCELLANEOUS

There is also the assumption that the cost of food is the same in 2019 as it was in 2016. No argument is presented for calculations to this effect but it is a circumstance that should be taken into account.

#### CONCLUSION

[REDACTED] understands her documentation submitted was unacceptable. She has made remedial steps including purchasing a new point of sale system and the documenting of waste, shrinkage, charitable giving and other removals from stock. I do not believe there could be anything criminal about this taxpayer. It is clear that the calculated [REDACTED] markup percentage

does not apply to [REDACTED] and we respectfully request the calculations as to sales tax due should be redone taking into account the totality of the circumstances as submitted in this review.

The understanding of the petitioner was this information is to be presented for the calculation of a firm sales mark up on food invoices taking into account the facts and circumstances of this case. [P.1 – 3].

In response to the Taxpayer's initial post-hearing submission on September 4, 2020, the Department's Representative responded, via email, as follows:

The Department has completed its review of the information submitted by [REDACTED] post hearing. The agreement was that Audit would review the submission to see whether any adjustments could be made. A review of the submission showed that any possible adjustment, based on the submitted information, would result in an increased assessment. The Department does not increase assessments, and there are no other supported adjustments. The details of the submission review will be explained further.

Of great importance, what matter is now left to be considered by Judge Howard for the Administrative Decision. As this case is about an estimated assessment resulting from an audit with insufficient documentation, the burden is on the taxpayer to show that the Department's calculations were not reasonable. The information submitted by [REDACTED] does not satisfy this burden of proof as the documentation shows that the actual mark-up should be higher and is inaccurate in relation to the charitable contributions/withdrawal from stock and waste issue. (Explained more fully below). As such, the assessment should be sustained in full.

#### Details of Audit's Review

The information provided by [REDACTED] does not warrant adjustments for the following reasons:

- A community death rate of [REDACTED] people per month appears to be very high. See Death Record for [REDACTED] Arkansas below. They should provide more concrete information with

regards to actual funerals/memorials for which they have donated food.

...

- [REDACTED] cost analysis for waste and charitable giving is showing the retail price/the price [REDACTED] would sell the items.
  - For example, a pound of tomatoes does not cost [REDACTED]. A single [REDACTED] does not cost [REDACTED].
  - Plates for [REDACTED] are priced at [REDACTED] per [REDACTED]; [REDACTED].
    - These items have to be withdrawn from mark up at cost.
- [REDACTED] continues to argue the mark up percentage used in the audit and states that paper goods should be removed from mark up.
  - In fact, if paper goods are removed, the mark up on just food is much higher (see table below).
  - The mark up of [REDACTED] used in the audit is representative of the mark-up shown on the taxpayer's income tax return for years under audit.
    - Therefore, the COGS used in the audit for mark-up purposes includes all items included in COGS on the income tax return. Attached is the excel file for the below mark-up analysis.

[Table omitted]

On September 25, 2020, the Taxpayer's Representative submitted another post-hearing document and stated as follows:

Submission on answer to written appeal.

The state must take into account all the facts and circumstances of the taxpayer when making a calculated assessment as in this case. When the state calculates sales using a percentage markup it should be reasonable in accordance with the fact and circumstances. The taxpayer has the burden to prove such assessment is not in accordance with the facts of the case.

Your Honor,

The state responded to the written appeal that any adjustment in accordance with the information submitted would increase the sales tax assessed and that the state was hesitant to do so. I reject this finding and give my argument as follows:

The appeal submission was divided into six different sections, the rebuttal by the state is divided into the six sections:

- Mark up;
- Paper Goods;
- Waste;
- Shrinkage;
- Charitable Giving; and
- Miscellaneous

### **Mark-Up**

The state presents a table indicating the mark-up on 9 items as having an average of [REDACTED]. The state presents this absurdity as the rationale that the mark-up should be higher.

An excel sheet with: Description; Unit Price; Unit of Measure; and, Cost per Unit of Measure was prepared by the state. This sheet with corrections is attached. The number of errors are too many to be listed here. Actual invoices were used in computing costs as a rule but [REDACTED] does not compute to the same price as [REDACTED].

[REDACTED] These are sloppy computations. The actual invoices are in the record and should be accessed to check for accuracy.

These inaccurate computations are carried forward for calculation the [REDACTED] average mark-up on the nine items.

Also, a mark-up table was prepared by the state and gives the unit cost of a large side as [REDACTED] which is the unit cost of [REDACTED] [REDACTED] which are included in the small side not the large side in the mark-up table. [REDACTED] comes with all the fixings. The fixings [REDACTED] are not included. The components of the dishes are not given and cannot be checked but the [REDACTED], for instance, is cost at [REDACTED] on the [REDACTED]. The computations on the [REDACTED] ignore the shrinkage of [REDACTED] (which we have testimony as being about a [REDACTED]).

I submit the states attempt to calculate the actual mark-up



be ignored as presented in these two tables because of inaccuracies.

Claiming the markup on the tax return was used as the basis for the markup on the audit is a false statement. The tax return was not referenced by the auditor for calculating the mark up percentage during the sales tax audit. The percentage chosen started at [REDACTED] and was calculated at [REDACTED]. This markup should be appropriate in other restaurants but does not fit the facts and circumstances submitted.

There was evidence given at the hearing by a [REDACTED] representative that the markup at [REDACTED] was not up to the standards used today. This is a circumstance indicating her markup is under the industry average. Menus from several restaurants in the area were provided in support of the evidence given. The state has ignored this part of the presentation and has submitted their own argument as to why the markup should be in excess of [REDACTED].

### **Paper Goods**

The tax already paid on the paper goods in the supplier invoices has been ignored.

Paper goods amount for about 10% of the checks written to vendors. The state does not give a rebuttal. The state says that if paper goods are removed from cost of sales that the calculated sales will be higher. For example: say all checks written for cost of goods is 10 and it includes 1 paper good. If 10 is used for the cost of sales we get sales of 14.28. If we remove 1 paper good from cost of sales we get 12.875 sales. The state needs to expand its argument.

### **Waste**

Copies of the taxpayer's original paperwork for waste have been submitted. The state does not deny the waste but takes exception to how the taxpayer measures it. Evidence was admitted as to the high amount of waste at the hearing. This evidence has not been rebutted. Waste increases cost of goods sold but does not generate revenue for the gross receipt tax and should not be included in the calculation for sales. This is a circumstance which should be considered.

### **Shrinkage**

Testimony was given at the hearing that [REDACTED] is subject to shrinkage.

Specifically mentioned was [REDACTED] referenced on the states table of actual costs and mark up percentage.

### **Charitable Giving**

[REDACTED] provides [REDACTED] and for the [REDACTED]. This is limited to [REDACTED] and the surrounding area. The state questions a community death rate of [REDACTED], the state has submitted an abstract search in the city of [REDACTED] for deaths during "Last 90 days". There are names on the report which appears to be for more than [REDACTED]. January has [REDACTED], just [REDACTED] for December, and [REDACTED] or October. The state presents this as evidence as if the city of [REDACTED], like all cities of [REDACTED], stands on its own and deaths in the surrounding communities are not counted. The actual population required for a death rate of 40 per year is right under 5,000 using US mortality tables. Perhaps the most important point is that the state does not dispute these acts of charity but the volume. The measurement is at retail because that is how [REDACTED] estimates the cost. There was no effort to hide that these were her representations at retail. There are letters of appreciation in the file and evidence of her giving on media. This is a circumstance that can be measured.

The state puts forth plates for the [REDACTED] should be withdrawn from the mark at cost. Yes, this should be done. I agree. These are not sales and should not be taxed as such.

### **Miscellaneous**

Previous years data was considered as if prices were consistent over a six year period. There has been a [REDACTED] increase in the price of goods from 2013 to 2019. This is a circumstance which can be measured and can be calculated, but has been ignored.

If given the opportunity I would work with the state to make such calculations for a more accurate assessment. For convenience sake.

### **Conclusion**

[REDACTED] is a [REDACTED]. Have more than one of the audit team walked in the door? This is part of the case. The building the restaurant is in has an estimated value of [REDACTED]. It has a total

floor area of [REDACTED]. A search of hidden wealth for the proprietor gives nothing.

The state has enthusiastically responded with a statement that the current calculations are less than the actual sales by a ridiculous factor of 5. The response is the state has ignored the facts and circumstances of the case. The restaurant cannot support that type of arbitrary sales tax assessment. The sales tax reports as filed are closer to actual than the state is willing to admit. [P. 1 – 5].

In response to an inquiry concerning receipt of the email (sent on September 25, 2020) from the Taxpayer's Representative, the Department Representative responded, via email, and stated that, "Yes, the Department did receive this submission. The Department's submitted correspondence and request for a decision was based on the review of all your submissions, including this one."

It is not disputed that the Taxpayer failed to maintain adequate business records during the audit period. The Department exercised its lawful authority and issued an estimated assessment against the Taxpayer using available information. See Ark. Code Ann. § 26-18-506(d) (Repl. 2020). Since the Taxpayer failed to maintain records necessary to prove the accuracy of its returns, the Taxpayer bears the burden of refuting the reasonableness of the Department's assessment.

One of the issues raised by the Taxpayer's Representative in order to challenge the reasonableness of the Department's assessment was waste. The parties did not reach an agreement regarding a percentage of waste to be allowed for the years in the audit period and the Taxpayer did not maintain any records evidencing any actual amounts of waste. The only documents in the case file, relating to waste, were compiled after the audit period for months not included in

the audit (January and February of 2020). In this case, it would require speculation to ascertain specific amounts (or a percentage) attributable to waste during the audit period. In the absence of any documentation prepared contemporaneous to any waste, the Taxpayer's claim regarding losses due to waste is insufficient to refute the Department's assessment.<sup>22</sup>

Another issue raised by the Taxpayer's Representative in order to challenge the reasonableness of the Department's assessment was charitable giving. Withdrawals from stock are subject to sales tax. See Ark. Code Ann. § 26-52-322(b) (Repl. 2020). A "withdrawal from stock" means "the withdrawal or use of goods, wares, merchandise, or tangible personal property from an established business or from the stock in trade of the established reserves of an established business **for consumption or use** in the established business or **by any other person**. [Emphasis added]." See Ark. Code Ann. § 26-52-322(a) (Repl. 2020). Arkansas Gross Receipts Tax Rule GR-18(D) addresses the taxability of a withdrawal from stock and states as follows:

D. WITHDRAWAL FROM STOCK.

1. Withdrawal of purchased goods. If a seller has a retail permit and purchases goods from its suppliers without paying tax to those suppliers claiming the "sale for resale" exemption and the seller withdraws the merchandise from stock and gives the merchandise to customers or other third parties, or uses the merchandise itself, then the value of this merchandise is a part of the seller's gross receipts or gross proceeds and the seller must remit the tax on the purchase price of the goods paid by the seller.

2. Withdrawal of manufactured or processed goods.

a. A business that manufactures or produces products and sells the products to third parties or at retail may at times transfer title to certain of those products to itself or give the products to another person or entity. The business should report and remit tax on the

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<sup>22</sup> The same rationale applies to the issue of shrinkage.

sales price of the products rather than the value of the raw materials used to manufacture or produce the products.

b. A business that manufactures or produces products and transfers title to certain of those products to itself in a capacity other than as the manufacturer should determine the tax treatment of the transfer as follows. If the business sells the products to third parties, then the business should report and remit tax on the sales price of the product rather than the value of the raw materials. If the business does not sell any product to third parties, the business is acting as a contractor and should report and remit tax on the cost of the raw materials withdrawn to produce the product.

Example 1: A business produces and installs windows. The business also sells windows to third parties without installation. When the business sells windows as a manufacturer to itself as a contractor, the business should remit tax on the sales price of the windows.

Example 2: A business produces and installs windows. The business does not sell any windows to third parties. When the business produces and installs the windows, it is acting only as a contractor and should remit tax on the value of the raw materials used to produce the windows.

3. The value of goods that are withdrawn from stock by sellers and donated to National Guard members, emergency service workers, or volunteers providing services in an area declared a disaster area by the Governor are exempt from tax and are not required to be reported as part of the seller's gross receipts.

4. Restaurants and other food sellers that allow employees to consume food free of charge must treat the food as a withdrawal from stock, unless all of the following apply:

- a. The food is surplus that would otherwise be discarded;
- b. The restaurant does not prepare food in excess of that expected to be consumed to create the surplus food; and
- c. The food is provided to the employees on an irregular and incidental basis, i.e. when such surplus exists.

5. Tax is due at the time the item is withdrawn from stock. The applicable local tax for a withdrawal from stock is determined by the location at which the item is withdrawn.

The [REDACTED] the Taxpayer provided for [REDACTED]

[REDACTED] were subject to tax as withdrawals from stock.

No evidence was introduced to establish that any of the free meals given away by the Taxpayer were not subject to tax under Arkansas Gross Receipts Tax Rule GR-18(D)(4) or Ark. Code Ann. § 26-52-322(b)(2)(B) (Repl. 2020). The evidence

presented by the Taxpayer regarding charitable giving does not operate to refute the reasonableness of the Department's assessment.<sup>23</sup>

The Taxpayer's Representative also contended that the assessment should be adjusted to provide an allowance for tax-paid purchases of paper goods. The Department's Representative and its witnesses contended that, given the audit methodology used in this case, the inclusion of tax-paid consumables in the cost of goods sold is irrelevant. The case file does not contain sufficient documentation to support the Taxpayer's position because some restaurant supplies are taxable consumables and some restaurant supplies may be purchased exempt for tax as sales for resale. Arkansas Gross Receipts Tax Rule GR-53 addresses the taxability of restaurant supplies and provides, in pertinent part, as follows:

**D. SALE FOR RESALE - RESTAURANT SUPPLIES.**

1. As a general rule, gross receipts derived from the sale of the following items to restaurants are exempt as sales for resale:

a. Paper, plastic, and styrofoam cups used for dispensing beverages and the paper and plastic lids for such cups; and

b. Paper and plastic bowls, paper boats, boxes, and containers used for dispensing food items, and the wrappers for such bowls, boats, boxes, and containers.

2. Gross receipts derived from the sale of the following items purchased by restaurants are not exempt as a sale for resale: paper plates; paper and plastic straws and stirrers; plastic tableware and utensils; paper napkins; paper sacks; and premoistened towelettes. However, restaurants or other food sellers that use paper plates or other containers for dispensing the food items sold may purchase the plates or containers exempt as a sale for resale.

Even assuming that the Department's position regarding the audit methodology is incorrect, the Taxpayer failed to present documentation to

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<sup>23</sup> There was some discussion by the parties about adjusting the assessment by assessing tax on the tax-paid paper goods at cost rather than retail value based upon documentation but apparently an agreement was never reached.

establish the percentage of paper goods purchased by the Taxpayer that were taxable. The case file does not contain any invoices reflecting tax-paid purchases of paper goods and the evidence presented by the Taxpayer regarding purchases of paper goods does not refute the reasonableness of the Department's assessment.

The Taxpayer's Representative presented numerous arguments challenging the reasonableness of the [REDACTED] over cost markup and requested that a lower markup of [REDACTED] be used to calculate the Taxpayer's estimated sales. Although the Taxpayer's Representative disputed any connection, the [REDACTED] over cost markup was consistent with the profit margins reflected on the corporate income tax returns filed by the Taxpayer in 2017 and 2018. In a Revision Decision issued in May of 2019, the Commissioner of Revenues delineated the authority of the Office of Hearings and Appeals and held that:

The duties of a hearing officer appointed by the Department are limited to reviewing written protests and making written findings as to the applicability of a proposed assessment or denial of a claim for refund. Accordingly, it is outside the scope of the duties of the hearing officer to provide taxpayers with guidance concerning the existence of programs to request a waiver of interest or penalties.

The Office of Hearings and Appeals does not have the authority to order or direct a re-audit of a matter submitted for consideration. Consequently, it would be outside the scope of the duties of a hearing officer to change the agreed upon markup percentage applied in an audit. The testimonial evidence presented by the witnesses for the Taxpayer, and the Taxpayer's arguments regarding the excessiveness of the assessment, are insufficient to preponderate in favor of a finding that the Taxpayer has refuted the Department's assessment. The

Taxpayer failed to maintain adequate business records. The Taxpayer did not introduce sufficient evidence or documentation to establish that the audit methodology and calculations, used by the Tax Auditor, were unreasonable.<sup>24</sup> See Leathers v. A & B Dirt Movers, Inc., 311 Ark. 320, 844 S.W.2d 314 (1992). Consequently, the evidence presented supports a finding that the Department correctly assessed sales tax against the Taxpayer.

### **Interest and Penalty**

Interest was properly assessed on the tax deficiency for the use of the State's tax dollars. See Ark. Code Ann. § 26-18-508 (Repl. 2020).

The Taxpayer failed to maintain adequate business records and significant underreporting of tax liability was established. Consequently, a negligence penalty was properly assessed against the Taxpayer under Ark. Code Ann. § 26-18-208(4)(A) (Repl. 2020).

### **DECISION AND ORDER**

The proposed assessments are sustained.<sup>25</sup> The file is to be returned to the appropriate section of the Department for further proceedings in accordance with this Administrative Decision and applicable law. Pursuant to Ark. Code Ann. § 26-18-405 (Repl. 2020), unless the Taxpayer requests in writing within twenty (20) days of the mailing of this decision that the Commissioner of Revenues revise the decision of the Administrative Law Judge, this Administrative Decision shall be effective and become the action of the agency. The revision request may be mailed to the Assistant Commissioner of Revenues, P.O. Box 1272, Rm. 2440,

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<sup>24</sup> The cited authority is also controlling and supportive of the Tax Auditor's determination that the Taxpayer was not entitled to an allowance for theft loss or shrinkage.

<sup>25</sup> The assessment for use tax was not protested.



Little Rock, Arkansas 72203. A revision request may also be faxed to the Assistant Commissioner of Revenues at (501) 683-1161 or emailed to [revision@dfa.arkansas.gov](mailto:revision@dfa.arkansas.gov). The Commissioner of Revenues, within twenty (20) days of the mailing of this Administrative Decision, may revise the decision regardless of whether the Taxpayer has requested a revision.

Ark. Code Ann. § 26-18-406 (Repl. 2020) provides for the judicial appeal of a final decision of an Administrative Law Judge or the Commissioner of Revenues on a final assessment or refund claim denial; however, the constitutionality of that code section is uncertain.<sup>26</sup>

**OFFICE OF HEARINGS & APPEALS**



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**RAY HOWARD**  
**ADMINISTRATIVE LAW JUDGE**

DATED: March 10, 2021

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<sup>26</sup> See Board of Trustees of Univ. of Arkansas v. Andrews, 2018 Ark. 12.