

1 (3Q05 and 4Q05), and 190.7 percent for 2006, were too low when compared with the 319.3 percent
2 alcoholic beverage book markup for 2007. The Department established alcoholic beverage sales for
3 3Q05 and 4Q05 and 2006 by markup. It conducted a shelf test using November 2007 purchase
4 invoices, a 1¼-ounce pour for liquor, and a 12-ounce pour for draft beer, to establish a 183.96 percent
5 beer markup and a 422.30 percent liquor and wine markup. It adjusted the alcoholic beverage cost of
6 sales by 2 percent for pilferage, and by 5 percent for 3Q05 and 4Q05 and 4.38 percent for 2006 for
7 complimentary drinks and self-consumption based on the same percentages of petitioner's recorded
8 complimentary restaurant sales. It added the beer markup to the adjusted beer purchases and the liquor
9 and wine markup to the adjusted liquor and wine purchases to establish taxable alcoholic beverage
10 sales, combined those audited taxable sales with the recorded restaurant sales, compared the sums of
11 those amounts with reported taxable sales, established differences that represented reporting error rates
12 of 11.82 percent for 3Q05 and 4Q05 and 12.40 percent for 2006, and applied those error rates to the
13 reported taxable sales for those periods to compute understated taxable sales of \$203,226. Petitioner
14 contends that the one-month test period is not representative because it was too short, the 1¼-ounce
15 liquor pour size is too small, and the allowance for complimentary drinks is insufficient.

16 On appeal, the Department suggested an alternate audit method. It reasoned that since it
17 accepted the 2007 recorded sales, the audited alcoholic beverage markup could be computed from the
18 2007 recorded alcoholic beverage sales and purchases (adjusted for self consumption) and applied to
19 the recorded alcoholic beverage purchases for 3Q05 and 4Q05 and 2006 (adjusted for pilferage and
20 self consumption). The Department compared the 2007 recorded alcoholic beverage sales with the
21 2007 recorded purchases reduced by 7 percent for self-consumption, and computed a 350.86 percent
22 markup. Next, it reduced the 3Q05 and 4Q05 and 2006 purchases by 2 percent for pilferage and by
23 7 percent for self-consumption, and added the 350.86 percent markup to the adjusted purchases to
24 compute understated sales that were \$8,260 less than the understated sales computed in the audit.
25 However, because the self-consumption allowance was increased to 7 percent, the unreported cost of
26 merchandise withdrawn for self-consumption was increased by \$5,183.

27 We find that the Department's alternate audit method to calculate the deficiency measure is
28 preferable. This audit approach requires no shelf test, therefore any issues related to the length of the

1 test period, pour sizes, or other shelf test errors become irrelevant. However, the Department
2 incorrectly computed the audited markup because it failed to consider the 2 percent allowance for
3 pilferage. We also conclude that the allowance for self-consumption should not be increased to
4 7 percent because petitioner has not provided documentation to support a greater allowance for
5 complimentary drinks. Rather, a self-consumption allowance that is similarly proportionate to
6 petitioner's recorded complimentary restaurant sales, that is, 3.39 percent for 2007 as used in the
7 original audit, is reasonable. Based on these allowances, we computed an alcoholic beverage markup
8 of 342.87 percent. Accordingly, we recommend that the 342.87 percent alcoholic beverage markup be
9 applied to petitioner's recorded purchases of alcoholic beverages for 3Q05 and 4Q05 and 2006,
10 adjusted by a 2 percent allowance for pilferage and allowances of 5 percent for 3Q05 and 4Q05 and
11 4.38 percent for 2006 for self-consumption, to compute the alcoholic beverage sales for those periods,
12 which results in a reduction in the understatement of \$3,520, to \$199,706.¹

13 **Issue 2:** Whether any adjustments to the unreported sales of fixtures and equipment are
14 warranted. We conclude that no further adjustments are warranted.

15 Petitioner and the purchaser of its business agreed that the value of the fixtures and equipment
16 was \$18,000. The Department reconciled the recorded sales with the sales reported on the final sales
17 and use tax return and found that the \$18,000 for the sale of the fixtures and equipment was omitted.
18 The Department included this sale in the audit measure. Petitioner has not provided any evidence that
19 this sale was reported elsewhere, or that the sale was not subject to tax. Accordingly, we recommend
20 no adjustment.

21 OTHER MATTERS

22 Prior to the scheduled Board hearing in August 2012, petitioner furnished profit and loss (P&L)
23 statements for 2005 and 2006 that included cost of bar sales that were different than those recorded in
24 the audit working papers. The Department has determined that the cost of bar sales on the 2005 and
25 2006 P&L statements did not include the journal entries for inventory adjustments that were included

27 ¹ The D&R recommends a reduction of \$3,516, but in applying our recommendation, the Department reduced the
28 understatement by \$3,520, which we assume was the result of rounding.

1 in the P&L statements provided at the time of the audit. Petitioner has confirmed that the journal
2 entries are valid. Accordingly, no adjustments are warranted.

3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Summary prepared by Pete Lee, Business Taxes Specialist II

1
 2
 3
 4
 5
 6
 7
 8
 9
 10
 11
 12
 13
 14
 15
 16
 17
 18
 19
 20
 21
 22
 23
 24
 25
 26
 27
 28

MARKUP TABLE

Percentage of taxable vs. nontaxable purchases	100% taxable
Mark-up percentages developed	342.87%
Self-consumption allowed in dollars	\$2,691 (2005) \$4,171 (2006)
Self-consumption allowed as a percent of taxable purchases	5.00% (2005) 4.38% (2006)
Pilferage allowed in dollars	\$1,099 (2005) \$1,944 (2006)
Pilferage allowed as a percent of taxable purchases	2%