NIKI'S FINLEY AVENUE, INC. 233 FINLEY AVENUE WEST BIRMINGHAM, AL 35204,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 05-270
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER

The Revenue Department assessed Niki's Finley Avenue, Inc. ("Taxpayer") for sales tax for June 2001 through May 2004. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. Assistant Counsel Wade Hope represented the Department. Sam McCord represented the Taxpayer.

The Taxpayer operates a popular cafeteria-style restaurant in Birmingham, Alabama. The restaurant has been serving meals since 1959, and is open for breakfast, lunch, and dinner, Monday through Saturday.

The restaurant has always displayed a menu board on which the entrees of the day are posted. The board also states the prices for the various meal combinations, i.e., a meat and two vegetables, a meat and three vegetables, a vegetable plate, etc.

A Revenue Department sales tax supervisor testified that when she ate lunch at the restaurant in early 2004, she observed that the menu board did not indicate that sales tax was either included in the listed prices or would be added to the prices.[1] After

[1]Several other Department employees also later observed that the menu board made no reference to sales tax.

she finished her meal, her waitress gave her a ticket that showed a lump-sum amount. Sales tax was not separately stated or otherwise mentioned on the ticket.

When the supervisor paid the ticket, she gave the cash register clerk more money than the cost of the meal. The clerk computed the change due on an adding machine and took the change out of an open cash register. The sale was not rung up on the register. The supervisor also later purchased gum and mints from the clerk. The clerk never made a sales ticket or rang up that sale on the register.

The supervisor subsequently assigned two examiners to audit the Taxpayer for sales tax. The Taxpayer's CPA was cooperative and provided the examiners with the Taxpayer's records. Unfortunately, cash register z-tapes were not provided.[2] The CPA did provide worksheets showing the Taxpayer's gross sales. The CPA had prepared the worksheets from daily sales information provided by the Taxpayer. The examiners compared the worksheets with the Taxpayer's bank deposits and found no significant discrepancies. They consequently accepted the worksheets as correct.

The CPA had backed out the combined 8 percent State and local sales tax from gross sales before computing the monthly sales tax due. The examiners determined, however, that the Taxpayer's total receipts were taxable, i.e., that the 8 percent tax should not be backed out, because the Taxpayer's menu board did not indicate that sales tax would be added, and there were no tickets, sales receipts, or other records showing that the Taxpayer had charged and collected sales tax from its customers. The final assessment in issue is based primarily on that adjustment. No other significant discrepancies were found in the audit.

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[2] As discussed below, the Taxpayer's owner claims that he maintained daily cash register tapes, but discarded them after a day or two.

The Taxpayer's owner testified that the restaurant has always added sales tax to the prices listed on the menu board. He also claimed that the menu board has always stated that sales tax and any drink cost would be added to the listed prices. He explained that the waitresses have cards that show the price of each meal combination without tax, the price with tax, and also an amount due if the customer orders a drink. For example, the card, Taxpayer Ex. 3, states that a meat and two vegetables (M-2) is $7.15 without tax, $7.72 with tax, and $8.75 if a drink is included. Consequently, if a customer had a meal and three vegetables without a drink, the waitress would give the customer a ticket for $7.72. If a drink was included, the ticket would be for $8.75.

The owner explained that when the customer gives the ticket to the cash register clerk, the clerk staples the ticket to the cash register receipt that is rung up for the sale. The "validated" sales are totaled at the end of the day and recorded in a sales journal. The tickets/cash register receipts are then discarded. The Taxpayer provides the sales journal to its CPA, who uses the data to compile the worksheets that are used to complete the Taxpayer's monthly sales tax returns.

The issue in this case is whether the Taxpayer collected sales tax from its customers during the audit period, as required by Code of Ala. 1975, §40-23-26(a). That section specifies that all retailers "shall add to the sales price and collect from the purchaser on all sales" the 4 percent State sales tax. Department Reg. 810-6-4-.20(3) also provides – "The initial invoice, bill, charge ticket, sales slip, or receipt shall separately state the amount of the tax being charged. If not separately stated, it will be presumed that sales tax was not charged to the customer or collected. In such cases, the measure will be the gross receipts."

The Administrative Law Division has decided numerous cases involving the issue of whether sales tax was included in a lump-sum price charged by a retailer. Those cases generally turned on whether the retailer had posted a sign stating that sales tax was included in the lump-sum price. See generally, *Dixie Novelty Co. v. State of Alabama*, S. 05-422 (Admin. Law Div. O.P.O. 9/29/05), and cases cited therein. This case is different because the Taxpayer concedes that sales tax was not included in the meal prices posted on the menu board. The issue thus is whether the Taxpayer added sales tax to the customers' tickets.

It is understandable that the Department concluded that the Taxpayer had not charged and collected sales tax because sales tax was not separately stated on the customers' tickets, and the Taxpayer maintained no cash register tapes showing that sales tax was charged. As indicated, Reg. 810-6-4-.20(3) also states that if sales tax is not separately stated, it must be presumed that sales tax was not charged. That presumption can, however, be rebutted with competent evidence that sales tax was included in the price and collected from the customer. See, *Bigbee Steel Buildings, Inc. v. State of Alabama*, S. 05-118 (Admin. Law Div. 6/1/05).

The parties disagree as to whether the Taxpayer's menu board indicated that sales tax was to be added to the meal prices listed on the board. I believe the Department supervisor's testimony that when she ate at the restaurant in early 2004, there was no reference to sales tax on the board. However, the board may have previously contained a statement concerning sale tax, and the statement may have been inadvertently or otherwise removed before the supervisor made her observation.

In any case, while the posting of a sign is important in situations where the retailer claims that sales tax was included in a lump-sum price, it is not determinative in this case because it is undisputed that sales tax was not included in the menu board prices. Rather, as indicated, this case turns on whether the Taxpayer actually collected sales tax from its customers. Consequently, even if the menu board did not state that sales tax was to be added to the listed prices, the Taxpayer could still back out sales tax if there is evidence that sales tax was actually added to the price and collected from the customer as part of the lump-sum ticket amount.

The Taxpayer's menu board listed prices for the various meal combinations. The tickets given to the customers were for lump-sum amounts greater than the listed board prices. The cards used by the waitresses show that the ticket amount consisted of the listed menu board price plus the applicable 8 percent State and local sales tax. For example, the listed price without tax for a meat and two vegetables was $7.15. Eight percent of that amount is $.57. The total ticket amount charged to the customer per the waitress card was $7.72, which is the total of the meal price of $7.15 plus the $.57 tax. The other "with tax" prices listed on the waitress cards also equal the base meal price plus 8 percent tax. The above evidence establishes that the Taxpayer added sales tax to the menu board meal prices and collected the tax from its customers. The Taxpayer should thus be allowed to back out sales tax from its meal gross proceeds.

The above does not apply to the amounts the Taxpayer charged for drinks. As discussed, the waitress cards listed a base meal price, a price for the meal plus tax, and a third column if the customer ordered a drink other than water. A meat and two vegetables with tax was $7.72, and with a drink was $8.75. There is no evidence,

however, that the additional $1.03 for the drink included sales tax. Consequently, the Taxpayer cannot be allowed to back sales tax out of its drink proceeds.

The above holding raises an obvious problem. That is, what part of the Taxpayer's gross receipts during the audit period represented food sales, and what part represented drink sales. There are no records distinguishing the two. The only reasonable method to resolve the problem is to compute the average meal charge and the average drink charge, add the two, and then determine what percentage of the total charge represents the drink charge. That percentage of the Taxpayer's drink-related gross receipts would then be taxed in full, without backing out the 8 percent tax. Tax would be backed out of the remaining, food-related gross receipts.

The listed meal prices for the various meal combinations, without tax, on the waitress cards are $7.35, $7.15, $6.75, $5.20, $6.40, $6.05, and $4.35. The average of the above amounts is $6.18. The additional drink charges per the cards range from $1.00 to $1.05, with the average being $1.02. The average charge for a meal and drink, without tax, is thus $7.23.[3] The average drink charge of $1.02 represents 14.11 percent of that amount. The Department should recompute the Taxpayer's taxable gross receipts by including 14.11 percent of its gross receipts as taxable in full. Sales tax should be backed out of the remaining 85.89 percent.

The above holding applies only to the unique and unusual facts of this case. Retailers are still required to keep accurate and complete records showing their business activities, and from which the Department can compute or verify their correct liability. The Taxpayer in this case has maintained its cash register z-tapes since the

[3] It must be assumed that the customers ordered a drink with every meal because the Taxpayer failed to maintain the tickets that may have established otherwise.

Department's audit began, and it must continue doing so. It is also recommended that the Taxpayer should include sales tax in the meal and drink prices listed on the menu board, and so state that the 8 percent tax is included. In lieu of the above, the tickets given to the customers should separately state the tax due.

This case is also atypical because the Department accepted the Taxpayer's sales amounts as reported, even though the Taxpayer failed to maintain its cash register tapes or other contemporaneous sales records. In prior cases where a taxpayer failed to keep sales records, the Department usually rejected the taxpayer's reported sales and computed the taxpayer's liability using a purchase mark-up audit. The Administrative Law Division has consistently affirmed the Department's authority to do so. See, *Garrett v. State of Alabama*, S. 05-1114 (Admin. Law Div. 7/24/06), *Randolph v. State of Alabama*, S. 06-291 (Admin. Law Div. 7/14/06), and cases cited therein. The Department's acceptance of the Taxpayer's reported sales is even more surprising given that the Department supervisor witnessed the cash register clerk not ringing up sales. But I do not question the examiners' decision to accept the Taxpayer's sales as reported. They performed a good audit under the guidance of their supervisor. The recomputations directed by this Order are based solely on the evidence submitted at the hearing in the case, not because of errors or omissions by the examiners.

The Department should compute the Taxpayer's liability as indicated above. It should notify the Administrative Law Division of the adjusted tax due, plus a 5 percent negligence penalty and applicable interest. A Final Order will then be entered.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered August 10, 2006.

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BILL THOMPSON
Chief Administrative Law Judge