Sales Tax Auditing – Bars & Restaurants

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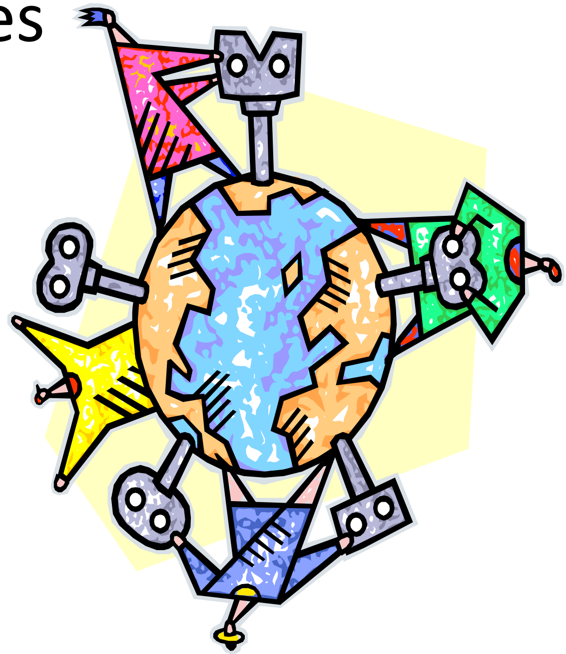
Ohio | Department of Taxation

Audit Division Mission

- Strategically ensuring compliance with Ohio tax law by conducting audit examinations while educating taxpayers of their tax responsibilities



What Is Sales Tax?

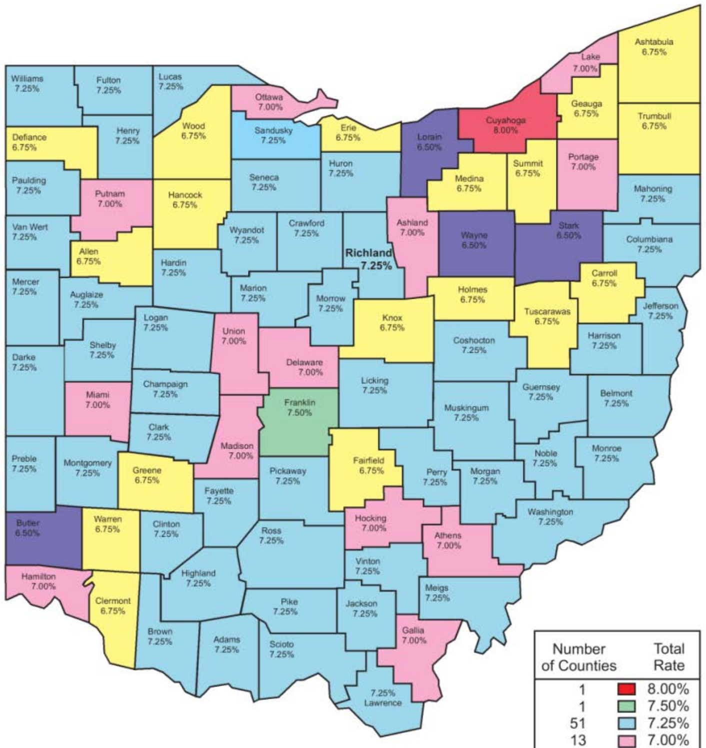
- Sales tax is a "trust" tax
- A "trust" tax means the consumer has entrusted this tax to retailers with the understanding that it will be reported and paid to the state of Ohio in a timely manner
- Vendors collect the tax on taxable services and retail sales and remit the tax to the State as a “trustee” of the State of Ohio
- The current state rate is 5.75% and counties and regional transit authorities may each levy sales tax increments of .25% up to 1.5

Consumers Use Tax

- Consumer's use tax must be paid on all taxable purchases of tangible personal property or services used, stored or otherwise consumed in Ohio unless Ohio sales tax has been paid to a vendor or the tax has been properly paid to another state.

- In general, if you have paid Ohio sales tax on the purchase of tangible personal property or a taxable service, you do not owe consumer's use tax on that transaction.

Total State and Local Sales Tax Rates, By County
Effective July 2015



Number of Counties	Total Rate
1	8.00%
1	7.50%
51	7.25%
13	7.00%
18	6.75%
4	6.50%

New Rates:
Richland county tax rate 7.25% (previously 7.00%)

Note: Small portions of Delaware, Fairfield, Licking & Union Counties assess a transit authority sales tax levy of 0.50% (not reflected on this map).

Ohio Department of Taxation
June 22, 2015

ORC 5739.01 Sales tax definitions

- (C) "Vendor" means the person providing the service or by whom the transfer effected or license given by a sale is or is to be made or given and, for sales described in division (B)(3)(i) of this section, …”

ORC 5739.01 Sales tax definitions

- (D)(1) "Consumer" means the person for whom the service is provided, to whom the transfer effected or license given by a sale is or is to be made or given, to whom the service described in division (B)(3)(f) or (i) of this section is charged, or to whom the admission is granted.

Characteristics of Industry

– Businesses who sell alcoholic beverages for on-premises consumption and/or food, primarily for on-premises consumption
– High number of small dollar sales and high percentage of cash sales
– Have a high rate of turnover of employees who often have access to the inventories as well as the cash

– 722513 Limited-Service Restaurants
– 722410 Drinking Places (Alcoholic Beverages)
– 722511 Full-Service Restaurants

Liquor Permit types

Permit Class	Description
D1	ORC 4303.13 Beer only for on premises consumption or in original sealed containers for carry out only until 1:00am
D2	ORC 4303.14 Wine and mixed beverages for on premises consumption or in original sealed containers for carryout only until 1:00am
D2X	ORC 4303.141 (Grandfathered Permit) Beer only for on premises consumption or in original sealed containers for carryout only until 1:00am
D3	ORC 4303.15 Spirituous liquor for on premises consumption only until 1:00am
D3X	ORC 4303.151 (Grandfathered Permit) Wine only for on premises consumption or in original sealed containers for carryout only until 1:00am
D3A	ORC 4303.16 Extend issued permit privileges until 2:30am
D5	ORC 4303.18 Spirituous liquor for on premises consumption only, beer, wine and mixed beverages for on premises, or off premises in original sealed containers, until 2:30am
D5I	ORC 4303.181 (Same as D5). Restaurant meeting certain criteria.
D7	ORC 4303.183 (Same as D5). RESORT area only.

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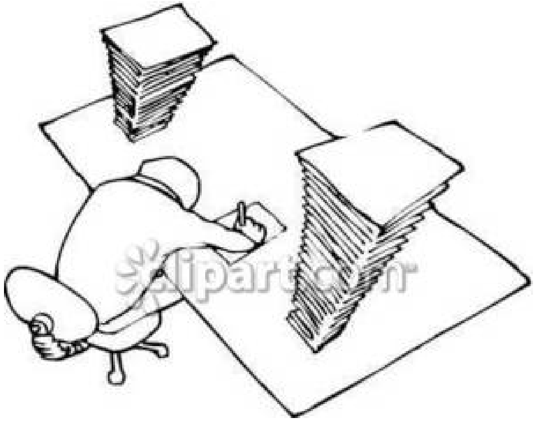
- Primary Goal:

- To verify the information reported on the Ohio sales tax returns



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- Q. Why?

- In order to verify that Ohio sales tax has been collected and remitted on all taxable sales transactions made by the taxpayer

Sales Tax Auditing - Bars & Restaurants

- Q. How?

- By auditing the business records of the business and comparing to the information reported on Ohio sales tax returns

Column Name	Datatype
id	INT(11)
employee_id	INT(11)
customer_id	INT(11)
price	DECIMAL(13,4)
date	DATE
delivery_date	DATE
extra_info	TEXT

ORC 5739.16 Four-year limitation for assessments - exceptions

- (A) "…no assessment shall be made or issued against a vendor or consumer for any tax…more than four years after the return date for the period in which the sale or purchase was made, or more than four years after the return for such period is filed, whichever is later…"

Effect of the Statue of Limitation on Ohio sales tax audits

- - Limits typical sales tax audit periods to 3 – 3 1/2 years

- - Audits need to be completed 90-120 days before the Statute date to allow time for review, processing and assessment

- - If an audit period is changed, both auditor and taxpayer should initial changes on Audit Commencement letter

- - Audit Division policy requires sales tax audits to be brought as current as possible
  – - relieves need for follow-up short period audits

- Bar and Restaurant audits

- Comparisons of Shrinkage
- The IRS and Other States/Countries

- Information was obtained prior to 2012

SOURCE OF INFO.	LIQUOR	DRAFT BEER	BOTTLE D BEER	WINE	PILFERAGE	SELF-CONSUMPTION
OHIO - PROPOSED	10%	5%	0%	5%	0%	0%
IRS				10%		
CALIFORNIA 1979 - 2000 PER CAL-TAX DIGEST	8%	3%	0%	3%		
CALIFORNIA 2001 - FWD PER CAL-TAX DIGEST	16%	14%	5%	10%		
CALIFORNIA AUDIT MANUAL - 2/2001	12%	10%	1%	6%	2%	2%
MARYLAND (PER Journal of State Taxation)	8%	?	0%	8%		
TEXAS (per Journal of State Taxation)	8%	10%	0%	8%		
STATES ON AVG (per Journal of State Taxation)				4 to 8%		
Owen Business Systems - Manufacturer & Vendor of Pour Control Systems				8 to 30%, avg of 23%		

Shrinkage Allowance Comparison

Background of liquor audits

- 1. IRS
- - Conducts audits of business gross receipts, not sales tax

- Audit Methods
- - Liquor Cost Percentage
- - Markup on Cost

- - As of 2011, the IRS allows a 10% spillage allowance on total inventory

Background of liquor audits

- 2. California

- - changed their spillage allowances in 2001
- 1) Liquor: from 8% to 16% 2) Wine: from 3% to 10%
- 3) Draft Beer: from 3% to 14% 3) Bottle Beer: from 0% to 5%
- - Reason: due to employee theft, breakage, give-aways and 2 for 1 pouring*

- Department's Position:
- Inventory losses not prohibited by law will be accepted if documented by the taxpayer

- * Source: Cal-Tax Digest, April 2001

Background of liquor audits

- 3. Ohio Department of Taxation
- The Department will require losses of inventory to be documented prior to an audit taking place
- Examples: Breakage – camera/phone picture or at minimum, a daily notation
- Theft – police/insurance report or at minimum, a daily notation with estimate of loss
- Inventory losses prohibited by law will not be accepted

- Department’s position: What was purchased is what was sold, less “documented” losses

Before any audit begins…

- Prior to the commencement of any bar and restaurant sale tax audit, pre-audit research is conducted by the auditor in areas such as:

- - taxpayer filing history
- - alcoholic beverage purchases
- - food sales
- - other sales activities
- - liquor permit violations

- Alcoholic beverage purchases and estimated food sales are compared to reported taxable sales and evaluated for validity

5739.13 Liability of vendor and consumer - assessment - petition for reassessment - penalties - appeal - judgment - execution.

- (A) "…When information in the possession of the commissioner indicates that the amount required to be collected or paid under this chapter is greater than the amount remitted by the vendor or paid by the consumer, the commissioner may audit a sample of the vendor's sales or the consumer's purchases for a representative period, to ascertain the per cent of exempt or taxable transactions…"

Bar and Restaurant Audit Methodology

- Current audit methodology relies on detailed sales and purchase information

- 1) Purchases – type/brand, size, quantity purchased
- 2) Sales - information on how the alcoholic beverage purchases were used

    - - how much alcohol used in each item sold
    - - how much charged for each drink sold
    - - how much was not sold and where it went

- More accurate information = more accurate audit result

Bar and Restaurant Audit Methodology

- Two different samples are utilized when conducting bar and restaurant sales audits

Bar and Restaurant Audit Methodology

- Sample 1 – Determines Inventory Category Markup %’s

- 1. Detailed sales information – 2-4 weeks of records suggested
- 2. Detailed alcoholic beverage purchase information
- – 1-2 months of records suggested
- 3. Alcoholic beverage price list
- 4. Alcoholic beverage serving sizes
- 5. Drink recipes
- - Ingredients and amounts contained in single-serving cocktails
- 6. Details on Happy Hour and Special pricing

Bar and Restaurant Audit Methodology

- Sample 1 – Determines Inventory Category Markup %'s

- 1. Sample used to determine alcoholic beverage category markup percentages – NOT taxable sales

- In order to allow for the most accurate result:

- 2. Individual brand/type markup percentages are weighted toward alcoholic drinks which are sold more (when several drinks use a single alcohol brand/type)

- 3. Category markup percentages are weighted toward alcohol brand/types which are purchased more

Item/Categories used in Markup Calculations

- 1. Beer-Bottle and Can 4. Wine
- 2.Beer-draft 5. Mixed Drinks
- 3. Single-serving liquor 6. Multiple-serving liquor

- *Dine-in food and Misc. taxable sales are determined using taxpayer sales records or estimated, if sales records are inadequate

Bar and Restaurant Audit Methodology

- Sample 2 – Determines Sample Period Taxable Sales
- 1. Alcoholic beverage category purchase totals – one year sample required
- 2. Dine-in food sales and/or misc. taxable sales, if applicable, for one-year sample period
- 3. Inventory spillage/over-pour allowance (pre-determined or documented)

Bar and Restaurant Audit Methodology

- Sample 2 – Determines Sample Period Taxable Sales
- - Category markup percentages are applied to one-year sample purchases, resulting in alcoholic beverage sales for the one-year sample period
- - Spillage/Over-pour allowance is credited against draft beer, liquor and/or wine sales, as applicable
- - Alcoholic beverage sales are combined with dine-in food sales and misc. taxable sales, as applicable, resulting in Total Taxable Sales

Mark-up comparison and percentages

- Calculated taxable sales are then compared with primary sales records/sales tax returns to evaluate the validity of the primary sales records/sales tax returns

- Only when the primary sales records/sales tax returns are determined to be lacking, would the auditor proceed to projecting an audit liability for the audit period

Inventory Shrinkage

- Allowances are given for :
- 1) Unintentional variations in the actual alcohol serving size when compared to the stated serving size
- 2) Undocumented breakage and spillage of alcohol
- Beer-draft 5%
- Wine-glass 5%
- Liquor- 10%
- Additional claims for loss above theses percentages must be accompanied by detailed and specific documentation

Inventory Shrinkage

- Allowances are not given for :

- 1) Intentional variations in alcohol serving size
- - prohibited by OAC 4301:1-1-50(A)(3)

- 2) Intentional giving away of alcohol by any employee
- - prohibited by ORC 4301.22(D)

- 3) Claims of inventory losses, not detailed in regard to specific area of loss

- 4) Any other disposition of alcohol prohibited by law

Notice

- Violations of Ohio liquor law do not reduce the tax liability of a business

- Auditors will assume full compliance with Ohio Liquor law

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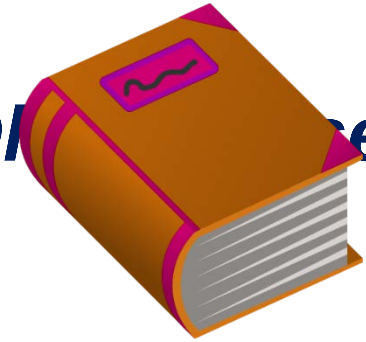
Ohio Administrative Code
&
Ol[illegible]sed Code



5703-9-02(C) Record Retention

- “All records must be preserved for a period of four years unless the commissioner consents, in writing, to their destruction within that period or by order requires that they be kept for a longer period.”

Record retention for food service vendors

- The sales tax law allows vendors conducting food service operations…an option of keeping fourteen (14) days of sales records per calendar quarter…If you elect not to retain the records of all your sales, the records of sales made on fourteen (14) days out of each quarter…are required to be kept for the four-year statutory period

- The Tax Commissioner wants all vendors considering this option to realize…tax liabilities under audit circumstances may be determined by test checks

Sales Tax Auditing- Bars & Restaurants

- Auditing the taxpayer’s books can involve:
- - Reconciling manual sales records (guest checks, register receipts, etc.) with the POS/Cash Register (i.e. where the primary sales records are maintained)
- - Reconciling the primary sales records with the sales
- tax returns
- - Reconciling the primary purchase records with the primary sales records and ultimately, the sales tax returns
-

OAC 5703-9-02 Maintenance of records

- "…(A)…Each vendor must maintain complete, accurate and adequate records which include both..."

- "…(A)…(1) Primary records such as purchase invoices, bills of lading, sales invoices, guest checks, exemption certificates, tax payment receipts, and cash register tapes; …"

OAC 5703-9-02 Maintenance of records

- "…(A)…(2) Secondary records such as bank deposit receipts and day books, journals, or any other records in which accumulated data is recorded. Secondary records must be supported by complete primary records…"

OAC 5703-9-02 Maintenance of records

- "…(B) Records are adequate if the records demonstrate to the tax commissioner that the vendor collected the proper amount of sales tax due on the vendor's taxable sales…"

Implications of OAC 5703-9-02(B)

- "…due on the vendor's taxable sales…" doesn't limit taxable sales to sales recorded in the cash register or Point-of-sale(POS) system

- - It also includes any taxable sales which were not recorded, for whatever reason

- Inventory purchased for sale must be accounted for and reconcile with total sales recorded and reported on the sales tax returns

OAC 5703-9-02 Maintenance of records

- "…(B)…(1) In order to be adequate, primary records such as sales invoices and cash register tapes for taxable sales must distinguish between taxable and nontaxable items. Further, the primary records must separately state the total amount of each transaction and the tax charged on the transaction. These amounts must accumulated and recorded in a secondary record…"

Implications of OAC 5703-9-02(B)(1)

- - During the audit, the auditor ‘s job is to verify that sales tax was charged correctly on each transaction
- - Daily, weekly or monthly cash register or Point-Of-Sale reports DO NOT satisfy the requirements of OAC 5703-9-02(B)(1) due to lack of individual transaction detail
- - Other issues which have been noted during audits:
- - price variances between individual sales items on register/POS reports
- - price variances on individual sales items not consistent with the required monthly price list
- - cash vs credit card transactions where different prices are charged on different payment methods

ORC 5739.29 Vendor to collect tax - prohibition against rebate

- “No vendor shall fail to collect the full and exact tax … or make in any form of advertising, verbal or otherwise, any statements which might imply that he…selling at a price including the tax...”

5739.05 Powers and duties of tax commissioner - payment by vendor on predetermined basis

- "…(B) Upon application, the commissioner may authorize a vendor to pay on a predetermined basis…

- C) Upon application, the commissioner may authorize a vendor to remit, on the basis of a prearranged agreement under this division, the tax…The proportions and ratios in a prearranged agreement shall be determined either by a test check…agreed to by the commissioner and the vendor or by any other method agreed upon by the vendor and the commissioner."

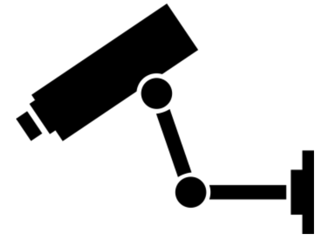
OAC 5703-9-02(D) Failure to maintain complete primary sales records

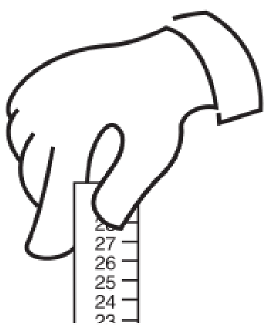
- "If any vendor fails to maintain complete primary sales records which may be utilized in verifying the accuracy of the figures reflected in their secondary records and/or reported on their tax returns, the commissioner may audit and assess as provided in section 5739.13 of the Revised Code."

Internal Controls

- Audit procedure includes discussions with the taxpayer regarding the internal controls employed by the business in order to combat theft, spillage, spoilage and other activities detrimental to proper functioning of the business

Proactive guidance for compliance





1. Creation and retention of primary records

A. Cash Register/POS system -

- Individual sales transactions information MUST be available, detailing items purchased and tax charged on each item

- If primary record detail is not going to be generated day to day, work with vendors to ensure that primary record details are retained and recoverable if necessary for audit purposes and periods

- OAC wording and requirements of POS records was presented earlier in presentation

B. Control and documentation of shrinkage

- * Not acceptable to combine all inventory short-falls into a single “inventory loss” category

- * Just because a business may accept inventory shrinkage as an acceptable cost of business DOES NOT relieve the business of its sales tax obligations

- * Business needs to have tracked inventory before an audit takes place

- * Many methods available to track inventory usage from the simple (measuring alcohol in the bottle, pre-mixing cocktails) to more detailed inventory tracking systems

B. Control and documentation of shrinkage cont.

- Record of losses, damage, theft must be contemporaneous with the event, kept in the regular course of business and maintained in a consistent manner with documentation

C. Maintain audit trail to tax returns

- Track happy hour periods and pricing
- Retain price lists required by Ohio Division of Liquor Control as a record
- Standardize and document known theft; Log police reports, photograph and date stamp vandalism, prosecute embezzlement, copy insurance claims and awards to your logs

The Appeals Process

Tax Procedures for Finalizing Assessments

23 DAYS
Sales tax returns are due the 23rd of the month following the tax period (monthly or semiannual)

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30 DAYS AFTER THE RETURN DEADLINE
Delinquency/Billing notice sent to taxpayer approximately 30 days after the return deadline

↓

30 DAYS AFTER THE DELINQUENCY/BILLING NOTICE
Assessment notice is sent to taxpayer by certified mail. This notice gives the taxpayer 60 days to appeal the assessment with instructions.

↓

60 DAYS AFTER THE ASSESSMENT IS DELIVERED
The taxpayer has 60 days from the assessment received date to pay in full or to file an appeal

↓

45 DAYS AFTER THE ASSESSMENT IS FINAL
Assessment is certified to the Attorney General for collection

↓

THE ATTORNEY GENERAL GIVES WRITTEN NOTICE OF ASSESSMENT CERTIFICATION AND BEGINS COLLECTION EFFORTS

1. The Assessment

- "ORC 5739.13(A)…The commissioner may make an assessment against any vendor who fails to file a return or remit the proper amount of tax required by this chapter…"

5739.33 Personal liability for tax

- "If any corporation, limited liability company… fails…to make the filing or payment, any of its employees having control or supervision of or charged with the responsibility of filing returns and making payments…shall be personally liable for the failure…"

5739.33 Personal liability for tax

- 1)Individuals responsible for filing returns and making payments may be held personally liable for any failure to file or make payment by the business
- 2) Business closure does not discharge liability
- 3) A Responsible Party Questionnaire must be completed by each owner of a business under audit for Ohio sales tax

ORC 5739.133 Penalties for failure to remit

- "(A) A penalty may be added to every amount assessed under section 5739.13 or 5739.15 of the Revised Code as follows:
- (1) In the case of an assessment against a person who fails to collect and remit the tax required by this chapter or Chapter 5741. of the Revised Code, up to fifty per cent of the amount assessed;

- (2) In the case of a person whom the tax commissioner believes has collected the tax but failed to remit it to the state as required by this chapter or Chapter 5741. of the Revised Code, up to fifty per cent of the amount assessed; …"

Reason for Penalties

- 1) Compliance function
- 2) Recovery of costs – reimbursement to the people of Ohio for costs incurred in auditing, assessing, litigating and collecting unremitted sales taxes
-

2. Petition for reassessment RC 5739.13

- \- 60 days from receipt of notice of assessment to
- file petition for reassessment by personal service
- or certified mail upon the Tax Commissioner

- \- Proper and timely petition for reassessment is
- jurisdictional - The Commissioner cannot waive
- the jurisdictional requirements

3. Proceedings on Petition RC 5703.60

- - A hearing may be requested in the petition

- - The Tax Commissioner may reduce, affirm or
- increase the assessment

4. Final determinations may be appealed to the Ohio Board of Tax Appeals, RC 5717.02

- - Individuals may represent themselves, Corporations
- must be represented by counsel

- - Appeal to BTA must be filed within 60 days of receipt
- of the final determination, copy of the appeal must be
- filed with the Tax Commissioner and the appeal must
- contain a description of the alleged error(s) in the
- final determination

5. Further appeals to Court of Appeals and/or Supreme Court of Ohio

Ohio Liquor Law

Tax Procedures for Permit Renewals

The Renewal of the Liquor Permit

- 1) Liquor Renewal Deadlines
- 2) Jeopardy letter and other notices
- 3) Appeal of Division of Liquor Control's Non-renewal order
- 4) Assessments under appeal receive conditional renewal of the permit

Tax Procedures for STC Permit Suspension Hearings

NOTICE 1
Upon issuance of a conditional renewal the Permit Offender's Program Notice 1 is sent. The notice details the parameters of the program, monitoring periods, and explanation of applicable penalties for late filing and late payment of tax.

NOTICE 2
Permit Offender's Program Notice 2 is sent to the taxpayer giving notice of any outstanding Sales Tax delinquencies. The taxpayer is given 14 days to comply.

COMPLAINT
Non-compliance of the Notice 2 results in a formal complaint to the Liquor Control Commissi requesting that the permit be suspended.

90 DAYS AFTER COMPLAINT
The taxpayer is docketed for a suspenion hearing.

3-4 WEEKS PRIOR TO THE HEARING
The notice of hearing is mailed to the permit holder. The taxpayer has this additional time to clear up delinquencies.

HEARING

7-14 DAYS AFTER THE HEARING
The order is sent to the permit holder with instructions for filing an appeal. The taxpayer has this time period to clear up liabilities and have an amended order issued by Taxation and/or the Attorney General's offices.

31 DAYS AFTER THE ORDER
The permit holder has an additional 31 days to clear up delinquencies.

SUSPENSION GOES INTO EFFECT 45 DAYS FROM THE HEARING DATE

ORC 4301.22 Rules for sales of beer and intoxicating liquor under all classes of permits and from state liquor stores

- “Sales of beer and intoxicating liquor…are subject to the following restrictions…

- (D) No holder of a permit shall give away any beer or intoxicating liquor of any kind at any time in connection with the permit holder's business…”

4301:1-1-50 Limitations on happy hours and similar retail price reductions

- “(A) No liquor permit holder, and…no employee…shall:
- (1) Offer to sell, furnish…to any person or group of persons:
- (a) Two or more servings of an alcoholic beverage upon the placing of an order for an individual serving of an alcoholic beverage;
- (b) An unlimited number of servings of alcoholic beverages during any set period of time for a fixed price;
- (c) Any alcoholic beverage after nine p.m. at a price less than the regularly-charged price, as established by the schedule of prices required in paragraph (B) of this rule…”
-

4301:1-1-50 Limitations on happy hours and similar retail price reductions

- “(A)…(3) Increase the volume of alcoholic beverages contained in a serving without increasing proportionately the price charged for such serving…”

4301:1-1-50 Limitations on happy hours and similar retail price reductions

- "…(B) All permit holders authorized to sell for on-premises consumption shall maintain on their permit premises a schedule of prices for all drinks of alcoholic beverages…Scheduled prices shall be effective for not less than one calendar month, dating from twelve p.m. on the first day of each month…"

4301:1-1-50 Limitations on happy hours and similar retail price reductions

- "…(B)…Prior to nine p.m., permit holders may sell, furnish, deliver, or allow the consumption of any alcoholic beverage at a price less than the regularly-charged price, as established by the aforementioned schedule of prices. Permit holders who do so may designate this time as happy hour periods."

Questions and Answers

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