# Comptroller's Office Increases Sales Tax Audits; *Part 5 of 5*

## What You Must Know

by
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*In this final installment to our five-part series covering the Maryland Comptroller's sales tax audits of alcoholic beverage license holders, we discuss penalties and interest, the basis for their imposition, and measures to seek abatement or reduction of both penalties and interest, which can significantly reduce the cost of your establishment's potential assessment, should you be audited.*

As we previously noted in the four previous editions of the *Maryland Beverage Journal*, the Comptroller has audited over 100 bars, restaurants, and other alcohol beverage license holders in the past five years, generating nearly $50 Million in assessments. To the extent your establishment is audited, however, there are several means to contest specific aspects of the audit assessment and methodologies employed by the state in estimating the gross taxable sales and additional sales tax due. To the extent your establishment is audited and assessed, this final part may prove the most vital to defending against penalties, which may effectively double the cost of the final assessment.

Maryland Tax Code §13-701 provides for a penalty of ten percent (10%) on all underpayments of sales tax. In addition, Maryland's tax code, like many state tax codes, provides greater penalties may be imposed in cases of fraud and/or gross negligence, typically involving an intent to evade the tax. Specifically, Maryland Tax Code §13-703 provides for a penalty of up to 100% of the tax in cases involving an intent to evade the payment of tax, in effect doubling the assessment. As previously mentioned in part one of this series, in Maryland sales tax cases in which the assessed tax is greater than 25% of tax previously reported, the assertion of gross negligence and/or fraud is automatic and can result in the imposition of 100% fraud penalties and the waiver of the statute of limitations, which is normally four years.

Fraud, or an intent to evade the tax, is often difficult for the taxing authority to prove, given that the taxpayer does not typically maintain direct evidence of such intentional acts to evade the tax. Therefore, state courts and taxing authorities, including the Maryland tax administration and judiciary, typically rely on certain "badges of fraud" as indicia that fraudulent intent exists sufficient to warrant the imposition of such severe penalty provisions. These "badges of fraud" have been adopted from federal court cases interpreting an analogous penalty provision. They include the following: (1) consistent and substantial understatements of sales; (2) failure to maintain adequate records; (3) implausible or inconsistent explanations of behavior, including the lack of credible testimony before a tribunal; (4) concealment of assets; (5) failure to cooperate fully with tax authorities; (6) awareness of the obligations to file returns, report income or sales, and pay taxes; and (7) failure to file returns. If the state demonstrates sufficient circumstantial evidence is present upon which to assert fraud, the taxpayer must refute the presence of these "badges," or indicia of fraud. No one badge is particularly more compelling than any other badge of fraud, and the existence of no one badge will typically result in a conclusion that fraud exists. How many "badges" or indicators of fraud, and just what level or frequency, is sufficient to support a finding of fraud, is typically fact-sensitive and varies from case to case.

Pursuant to Maryland Tax Code §§13-714 and 13-606, the Comptroller may waive penalties and interest for reasonable cause. Taxpayers have successfully defended against penalties by asserting that reasonable cause exists on the basis that the taxpayer reasonably relied on the advice or assistance of a sales tax professional, attorney or accountant in preparing and remitting their sales tax returns. This argument is buttressed by Internal Revenue Code §6662 and its interpretive decisions, which provide that penalties may be abated where there is a finding of "reasonable cause" and "good faith" on the part of the taxpayer, including the taxpayer's reliance on the advice of a tax professional, attorney or accountant.

In attacking the indicia that fraud exists, or simply arguing in support of abatement of all penalties, taxpayers should not only be prepared where appropriate to demonstrate that they relied on the advice of a tax accountant or attorney, but also demonstrate any of the following factors: their lack of sophistication, education, business acumen

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and/or industry experience; a lack of an awareness of their obligations; any regular pattern of proper tax compliance; the maintenance of bank accounts to maintain sales tax collections and enhance their tax compliance; complete and accurate business records, even if for a period; any other actions of the taxpayer that rebut the inference of a pattern of consistent and substantial underpayment of taxes. Surprisingly, inadequate records and inconsistent tax filings can also be presented by the taxpayer to demonstrate their lack of sophistication and expertise, their reliance on their tax experts, and therefore lack of intent to evade tax.

In conclusion, there are numerous opportunities to contest specific aspects of a sales tax audit of alcohol beverage license holders. Some of these include: the Comptroller's methods in conducting a purchase analysis; the Comptroller's assumptions in computing the mark-up, such as breakage factors, pricing and serving sizes. Equally important is the presence of sufficient direct evidence to rebut the imposition of a fraud penalty. In this and all regards, the importance of documentation and evidence in these audits cannot be overemphasized. Bar and restaurant owners should invest in point-of-sale (POS) system, and should conduct regular inventory audits. All records should be maintained for at least four years. Implementing these internal controls should pay for themselves in improved profitability, regardless of whether the establishment is audited. To the extent an establishment is audited, taking such actions will demonstrate that the taxpayer has proactively taken reasonable measures to meet their sales tax obligations, which should serve to mitigate any potential penalties. Lastly, a taxpayer facing a sales tax audit should seek the counsel of a sales tax professional experienced in the audit methods of the state, and the support required to successfully resolve the potential assessment and penalties.

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## Dinner Features Vignobles LVDH Wines

Bud's at Silver Run (a fine dining restaurant located eight miles north of Westminster) and Crossroad Liquors (a liquor store in Westminster) recently partnered to offer their first wine dinner. Alphonso Ventrice of Vignobles LVDH was the guest speaker.

Though the rolling hills of Carroll County may not seem the ideal venue for a fine dining establishment, Bud's at Silver Run is providing just that. Ken Lurie, owner/operator of Bud's, has created an eloquent atmosphere for those in search of something beyond the offerings of a grill and deep-fryer. "We've really started to build a base of customers and more and more people are getting the word that we are here and what we offer," stated Ken.

In conjunction with Jason Cake of Crossroads Liquors and Alphonso Ventrice of Vignobles LVDH, Bud's at Silver Run held a very successful Wine Dinner and is looking to continue this trend.

*At the wine dinner at Bud's at Silver Run are (l-r) LeRoy Stewart, chairman of the Carroll County chapter of the American Wine Society; Alphonso Ventrice, state manager, Vignobles LVDH; Brooke Hagerty, general manager, Bud's at Silver Run; Jason Cake, owner, Crossroads Liquors; and Ken Lurie, owner, Bud's at Silver Run.*

## Restaurant Association of Maryland Holiday Party

The Restaurant Association of Maryland (RAM) recently held their annual Holiday celebration at their headquarters in Columbia. The event was a great success and offered industry members the chance to reflect on the achievements of 2008 and a look forward at 2009.

*Enjoying the RAM holiday party are Jordan Naftal (l), Jordan's Steakhouse; and Tom Gussen, Metromedia Energy.*

*Here are (l-r) Matt Kimmel, Rory Callahan, and Evera Rutledge, all with RAM; at the association's holiday party.*