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SALES/USE TAX FOR ALCOHOLIC BEVERAGES IN A BAR OR RESTAURANT

Ohio sales and use tax statutes presume that tax is owed on all sales/use of tangible personal property, which includes alcoholic beverages.

LIQUOR MARK-UP:

Ohio Revised Code § 5739.11 mandates that “[e]ach vendor shall keep complete and accurate records of sales, together with a record of the tax collected on the sales, which shall be the amount due...”.

When auditing a bar or restaurant, the Ohio Department of Taxation (ODT) may utilize a liquor mark-up approach to calculate the sales/use tax liability for alcoholic beverages and then compare it to actual sales/use tax filings and payments. The IRS also uses this method in their audits. With this technique, third-party information from beverage distributors is used to verify purchases and compute the mark-up on cost. A mark-up audit is necessary when the detailed primary records are not available or do not appear to be complete and/or accurate based upon other information obtained by ODT. If the Commissioner concludes that the necessary information was lacking, the Commissioner is not only entitled but required to gather information from sources and estimate the amount of taxes which should have been collected and remitted. Cash register records only substantiate those sales that are rung into the register, and do not capture “comped” drinks, cash transactions that are not rung up, or product loss due to spillage, breakage or pilferage. (NOTE: Ohio Revised Code §4301.22(D) prohibits providing alcoholic beverages free of charge.) When appealed, the liquor mark-up method has been consistently upheld. See: BTA 2002-1910 (Jelly Rolls, Inc. vs. Zaino); BTA 97-534 (Nikolaos H. Argyris DBA Clubhouse Sportsbar & Grill vs. Tracy); BTA 97-1179 (T & D Tavern, Inc. DBA Cagney’s vs. Tracy).

ALLOWANCE FOR WASTE:

There is no provision in Ohio law for spillage, breakage, or pilferage. The presumption is that all alcoholic beverages purchased from a distributor will be resold to the customer of the bar or restaurant. *THE TAX FILER BEARS THE BURDEN OF DEMONSTRATING WHAT HAPPENED TO THEIR INVENTORY.* An auditor will

accept specific documentation to account for lost product, if the tax filer is able to provide that documentation. For example, a daily summary documenting alcoholic beverages lost to breakage or



spillage showing the number of containers lost by size, brand or type of drink and size would be acceptable. In the absence of specific documentation, a few states, and the IRS, use standard allowances when conducting audits (see below). Florida and New York consider the need for an allowance on a case-by-case basis. In the other states, no allowance is granted at all.

- IRS: 10%
- California: 5% for bottled beer; 10% for wine; 14% for draft beer; 16% for liquor
- Maryland: 8% for liquor and wine
- Connecticut, Massachusetts and **Ohio**: 5% for draft beer; 10% for liquor
- Tennessee: 15%
- Texas: 0.1 ounce for poured liquor (approximately 8%); 10% for poured beer

SAMPLING, PRODUCT MIX AND THE AUDIT PROCESS:

ODT and the tax filer generally enter into a standardized sampling agreement, establishing the sampling periods and methodology. The agreement may be adjusted to account for variables specific to the tax filer's business. If the tax filer disagrees with the proposed methodology, the tax filer has ten (10) days to propose alternate procedures for consideration. A mark-up analysis is typically used to determine the completeness, accuracy and adequacy of the business's sales records and of the reported taxable sales. If a detailed mark-up analysis is justified based on the initial analysis, the process outlined in the following paragraphs is used for alcoholic beverages. (If food is served by the establishment, the taxable food sales are also analyzed. That audit process is not documented here.)

The mark-up percentage for each inventory category is calculated as a weighted average of a representative sample of the most popular premium, standard and economy brands/products. First, a percentage is calculated for each brand within the category. Inventory invoices are used to establish cost; the business's corresponding price list is used to establish sales price. Individual brand markups are then weighted based upon brand inventory cost for the sample period (typically one (1) month).

The number of brands or products included within each sample varies by inventory category. For the categories of Beer-Bottle/Can, Beer-Draft, Liquor-Single Serving/Mixed Drink, Mixed/Malt-Based Drinks (e.g., Wine Coolers) and Wine, the product sample consists of all of the drinks purchased during the sample period (usually one (1) month). Because Liquor-Multiple Serving/Cocktail Drinks contain multiple products that are not sold in the same form as purchased, the sample size for this category is established by the auditor in consultation with the tax filer and includes a variety of the business's most popular cocktail drinks. Depending upon the size of the venue, the variety of drinks, and the representative percentage of the most popular drinks, a sample size of five (5) to twenty (20)



cocktail drinks or multiple shots is typically used. These cocktail drinks are then weighted based upon an analysis of the business's sales records.

Inventory purchase records are reviewed and summarized by the above categories for a representative sample period (typically one (1) year). The calculated mark-up percentages are applied to determine taxable drink sales, which are then discounted using the waste allowances described above. The results are compared to actual tax filings and any over/underpayment is estimated. The auditor's work goes through a review and approval process within ODT's Audit Division. The tax filer is then provided with the preliminary findings and worksheets detailing the audit calculations, as well as the Letter of Confirmation. The tax filer has thirty (30) days to provide additional records or information that may affect the audit findings.

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