

SC98601

IN THE SUPREME COURT OF MISSOURI

SEBA, LLC,

Appellant,

v.

DIRECTOR OF REVENUE,

Respondent.

**Appeal from the Administrative Hearing Commission of Missouri
The Honorable Renee T. Slusher, Commissioner**

RESPONDENT'S SUBSTITUTE BRIEF

**ERIC S. SCHMITT
Attorney General**

EMILY A. DODGE
Assistant Attorney General
Missouri Bar No. 53914
P.O. Box 899
Jefferson City, MO 65102
573-751-7344
573-751-9456 (facsimile)
Emily.Dodge@ago.mo.gov

ATTORNEYS FOR RESPONDENT

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JURISDICTIONAL STATEMENT

“A case involves the “construction of the revenue laws of this state” if it satisfies three separate elements: ‘(1) construction (2) of revenue laws (3) of this state.’” *Armstrong-Trotwood, LLC v. State Tax Comm’n*, 516 S.W.3d 830, 834 (Mo. banc 2017), *quoting Alumax Foils, Inc. v. City of St. Louis*, 939 S.W.2d 907, 910 (Mo. banc 1997). In *Alumax Foils*, the “construction” element was “not at issue” as this Court considered its jurisdiction. *Id.*

This Court has stated that “construction signifies determining the meaning and proper effect of language by a consideration of the subject-matter and attendant circumstances in connection with the words employed.” *Hermel, Inc. v. State Tax Comm’n*, 564 S.W.2d 888, 897 (Mo. banc 1978), *quoting Dorrance v. Dorrance*, 148 S.W. 94, 98 (Mo. 1912) (internal quotation marks omitted). A case that involves applying to the facts of a particular case a term in a statute (e.g., “true value in money”) that has been construed or defined in a prior opinion is not within this Court’s exclusive jurisdiction. *Hermel, Inc.*, 564 S.W.2d at 897.

SEBA argues that the assessment of an addition to tax for negligence under §144.250.3 was not supported by competent and substantial evidence (App.’s Subst. Br. at 28, 64, 67, 79). Resolving the merits of that argument requires applying “negligence” as used in §144.250.3 to the facts of this case.

Subsection 3 authorizes an addition to sales tax “equal to five percent of the deficiency” where a taxpayer has failed to pay the full amount of tax required by the Sales Tax Law on or before the prescribed date “due to negligence or intentional disregard of rules and regulations, but without intent to defraud[.] ...” Section 144.250.3, RSMo. If the “addition to tax” is a “tax,” §144.250.3 is a revenue law of the state under the *Alumax Foils* test. 939 S.W.2d at 910.

“Taxes are ‘proportional contributions imposed by the state upon individuals for the support of government and for all public needs.’ ” *Leggett v. Missouri State Life Ins. Co.*, 342 S.W.2d 833, 875 (Mo. banc 1960). An addition to tax is proportional to the amount of an individual taxpayer’s deficiency. Section 144.250.3, RSMo. The amount of the addition is determined by applying a rate set by §144.250.3. *Id.* An addition to tax imposed under §144.250.3 is at least arguably a tax. “After all, taxes—as we generically refer to them—are calculated based upon the tax rate... ” *Armstrong-Trotwood, LLC*, 516 S.W.3d at 836.

This Court has not previously addressed what the legislature meant when it used the word “negligence” in §144.250.3. This case presents a question concerning the construction of the term “negligence” in §144.250.3. If an addition to tax authorized by §144.250.3 is a “tax,” this appeal falls within this Court’s exclusive jurisdiction.

SEBA argues that this case also involves the construction of §144.250.4. App.’s Subst. Br. at 34. Nowhere in the Point I argument section of SEBA’s Substitute Brief does SEBA ask this Court to construe or define the meaning of any word in §144.250.4. Instead, SEBA argues that the auditor’s calculations were not supported by substantial evidence, and that “the auditor’s methodology and her \$8.06 average retail sale estimate... were based on nothing more than erroneous presumptions, and speculation, which were without support in the record.” App.’s Subst. Br. at 47. The auditor’s estimate methodology and its results are part of the facts of the underlying case. *See Hermel, Inc.*, 564 S.W.2d at 897.

Section 144.250, RSMo does not identify any factor that the Director is required to use in making an estimate of a taxpayer’s gross receipts “in respect to which he failed to make return and payment[.]...” Section 144.250.4, RSMo.

The plain language of §144.250.4 requires the Director to “make an estimate based on any information in his possession or that may come into his possession, of the amount of the gross receipts of the delinquent for the period” Section 144.250.4, RSMo. This unambiguous language authorizing the Director to consider “any information” in making his estimate leaves no room for construction “beyond applying the plain meaning of the law.” *Bateman v. Rinehart*, 391 S.W.3d 441, 446 (Mo. banc 2013) (quoting cases).

Nevertheless, SEBA asks this Court to read into §144.250.4 limitations, such as specific “factors” the Director may consider in estimating a delinquent taxpayer’s gross receipts, and what methodology the Director may use in making an estimate when required by §144.250.4. App.’s Subst. Br. at 34. SEBA failed to preserve that argument by raising it in a Point Relied On. *Howard v. City of Kansas City*, 332 S.W.3d 772, 791 (Mo. banc 2011); *Piatt v. Ind. Lumberman’s Mut. Ins. Co.*, 461 S.W.3d 788, 794 n. 4 (Mo. banc 2015). Nor has SEBA adequately developed or supported that argument in its briefing. *See id.*

Further, this Court lacks “ ‘authority to read into a statute a legislative intent that is contrary to its plain and ordinary meaning.’ ” *State ex rel. Heart of Amer. Council v. McKenzie*, 484 S.W.3d 320, 327 (Mo. banc 2016), *quoting State v. Rowe*, 63 S.W.3d 647, 650 (Mo. banc 2002). This Court “ ‘cannot rewrite the statute.’ ” *Id.*

If the “addition to tax” authorized by §144.250.3 is not a tax, this case does not fall within this Court’s exclusive jurisdiction.

STATEMENT OF FACTS

Brad Arteaga owned 75% of SEBA LLC. App. A2 (LF 101, ¶2, n. 1). SEBA LLC (doing business as Eddie’s Southside Donuts) (“SEBA”) has operated a doughnut shop in St. Louis, Missouri, since February 2007. App. A2 (LF 101, ¶1). Arteaga has a professional photography business at a different location in St. Louis. TR at 7, l. 4-5, 8-12, p. 25, l. 18-25; Ex. A, pp. 81, 87.

Eddie Strickland owned 25% of SEBA. App. A2 (LF 101, ¶2, n. 1). Strickland performed day-to-day tasks such as making the doughnuts from a mix, packaging and delivering wholesale orders, selling doughnuts and beverages from the shop’s retail counter, and ordering supplies. App. A2 (LF 101, ¶4). SEBA’s shop “was open for business from 5:00 a.m. to 12:00 p.m., seven days a week.” App. A2 (LF 101, ¶3).

The Missouri Department of Revenue conducted a sales tax audit of SEBA for the time period between October 1, 2011, and September 30, 2014. App. A5 (LF 104, ¶31); Ex. A, pp. 1, 15, 21, 71. On October 16, 2014, the auditor asked for copies of SEBA’s business records, including sales and use tax returns with schedules, federal income tax returns, sales journals, sales invoices, purchase invoices, sales tax exemption certificates and letters, detailed general ledger, 1099-K forms, and bank statements. Ex. A, p. 71; App. A5 (LF 104, ¶28).

Arteaga “handled all of SEBA’s financial affairs.”¹ On October 28, 2014, the auditor sent Arteaga a letter informing him of his responsibility to retain records concerning the operation of SEBA as required by §144.320.

Pursuant to Section 144.320, RSMo, “Every person engaged in the business as defined in section 144.010 of this chapter in this state shall keep such records and books as may be required by title 26, the United States Code, for federal income tax purposes. Such

¹ App. A2 (LF 101, ¶5)

books and records and other papers and documents shall, at all times during business hours of the day, be subject to inspection by the director of revenue or his duly authorized agents and employees. Such books and records shall be preserved for a period of at least three years, unless the director of revenue, in writing, authorized their destruction or disposal at any earlier date."

Ex. A, p. 73, quoting Section 144.320, RSMo.

SEBA provided the auditor "with its sales tax returns, bank statements, 1099-K forms for 2012 and 2013, federal income tax returns, depreciation schedules, bank statements, some purchase invoices, payroll registers, W-2s, and a general ledger." App. A5 (LF 104, ¶32); TR at 69, l. 11-16. Those records were not complete. TR at 69, l. 11-19; Ex. A, pp. 16, 17.

SEBA had no tax exempt letters, but obtained copies from some of its exempt customers and provided those letters to the auditor. App. A5 (LF 104, ¶34).

SEBA had no individual sales receipts for the audit period. App. A12 (LF 111). SEBA's cash register, which was used for retail sales, printed a single receipt for each sale. App. A3 (LF 102, ¶15). SEBA's business practice was to throw a receipt away if a customer did not want it. App. A3 (LF 102, ¶16). Arteaga explained that SEBA did not keep the receipts because the receipts "would be trash that we would have to get rid of." TR at 28, l. 21-24. The auditor asked SEBA to retain individual cash register receipts for the month of December 2014. App. A5-A6 (LF 104-105, ¶35); Ex. A, p. 17. SEBA "only provided individual receipts for 2 days during the month." Ex. A, p. 17.

The cash register did not generate Z tapes (App. A3 (LF 102, ¶17; Ex. A, pp. 17, 19). SEBA had no "secondary method to track sales." App. A3 (LF 102, ¶17). SEBA "chose not to have a method by which it documented its sales." App. A18 (LF 117).

SEBA lacked records of individual credit card sales. “Instead, the credit card machine printed a piece of paper with the batch total of the sales for the day.” App. A4 (LF 103, ¶18). 1099-K forms were not provided for the full audit period. Ex. A, pp. 16, 18; App. A5 (LF 104, ¶34); TR at 69, l. 11-16.

Arteaga counted SEBA’s cash once a week. TR at 26, l. 19-24. He deposited funds in SEBA’s bank account “weekly.” App. A4 (LF 103, ¶22).

Arteaga claimed that he leased part of the building housing SEBA’s shop to an unnamed tenant. App. A4 (LF 103, ¶23); TR at 19, l. 6-13, p. 41, l. 25 through p. 42, l. 4, p. 50, l. 9-23. Arteaga testified that he kept SEBA’s business records in a metal desk in the area that he leased to the tenant. TR at 19, l. 6-16; see App. A4 (LF 103, ¶23). According to Arteaga, the tenant sent someone to clean out the leased portion of SEBA’s building “the weekend before, that I thought it was going to take place,” TR at 50, l. 17-19, who removed the metal desk that contained SEBA’s records, as well as stainless steel shelves and display cases that Arteaga stored there, TR at 50, l. 14-24.

Arteaga testified that the tenant took the metal items, including the desk, to a recycler. TR at 19, l. 8-13. Arteaga did not have an agreement with the tenant that the tenant “was not to remove... the desk with all of your records in it[.] ...” TR at 50, l. 14-17. Arteaga testified that the tenant disposed of the desk with SEBA’s records “prior to the Director’s audit[.]...” App. A4 (LF 103); TR at 50, l. 4-8.

SEBA sold doughnuts, doughnut holes (App. A3 (LF 102, ¶14); TR at 87, l. 2-16), “black coffee, milk, soda and water.”² The Commission noted that a photograph in SEBA’s Exhibit 8 shows “a substantial number of donut holes displayed in SEBA’s retail display case as if for sale[.]” App. A3 (LF 102, ¶14, n. 5). See Ex. 8, p. 2. Exhibit 13 shows “that SEBA sold donut holes to

² App. A2 (LF 101, ¶3)

Emmanuel Episcopal Church on several occasions... ” App. A3 (LF 102, ¶14, n. 5). See Ex. 13, pp. 17-18. The doughnut hole sales to Emmanuel Episcopal Church included a May 4, 2014, sale of 43 dozen doughnut holes for \$49.00 and a September 18, 2014, sale of 20 dozen doughnut holes for \$25.00. Ex. 13, p. 8.

“SEBA charged its wholesale customers \$5.35 for a dozen donuts. It charged its retail customers \$8.00 for a dozen and \$.75 for a single donut.” App. A3 (LF 102, ¶10).

SEBA “did not have inventory numbers establishing the number of donuts and donut holes made and sold and the number of drinks sold during the audit period.” App. A12 (LF 111). “SEBA’s drink prices and its volume of sales of coffee, milk, soda, and water is not contained in the record.” App. A3 (LF 102, ¶13).

Arteaga testified that the average walk-in purchase consisted of “a couple donuts and a cup of coffee” (TR at 19, l. 20 through p. 20, l. 1), which cost “less than \$3.” TR at 35, l. 15-18. But, before the next question was posed to Arteaga, Arteaga added, “We would make one pot of coffee a day, and... Eddie probably had half of that... Our coffee sales were horrible.” TR at 20, l. 5-8.

“Because SEBA had limited documentation of its retail sales, [the auditor] asked SEBA to retain the individual cash register receipts for December 2014, with the beginning and ending inventory of donuts made in the shop for the month.” App. A5-A6 (LF 104-105, ¶35); Ex. A, p. 17. SEBA “only provided individual receipts for 2 days during the month.” Ex. A, p. 17. The auditor also found that “[t]here were missing batch totals during the month” of December 2014. Ex. A, p. 17. The auditor then requested SEBA’s sales records for April 2015 through June 2015, “but SEBA did not retain the requested records.” App. A6 (LF 105, ¶36), A12 (LF 111); Ex. A, p. 17.

Records that SEBA provided to the auditor for July 2015 sales

After SEBA failed to maintain and supply to the auditor the sales records that she had requested for the months of December 2014, and April through June 2015, App. A5-A6 (LF 104-105, ¶¶35, 36), A12 (LF 111); Ex. A, p. 17, the auditor “requested sales documentation for July 2015.” Ex. A, p. 17; see App. A6 (LF 105, ¶37). “... SEBA provided her with a notebook prepared by Strickland containing handwritten entries of its reported number of donuts made for wholesale and retail, donuts sold at retail, and donuts thrown away as waste.” App. A6 (LF 105, ¶37). The auditor discussed information in the notebook in her audit summary report. See Ex. A, p. 17. The auditor also recorded figures from the notebook in tables that can be found at pages 57 and 58 of Exhibit A. Ex. A, pp. 57-58; see TR at 69, l. 20-25.

The notebook itself was not in evidence. App. A6 (LF 105, ¶37 n. 7). “Arteaga testified that after the audit, he could not recall where he stored the notebook.” App. A6 (LF 105, ¶37 n. 7). Specifically, Arteaga could not remember where in his photography studio he had put the notebook. TR at 25, l. 18 through p. 26, l. 1.

The auditor determined that she could not rely upon the handwritten entries in the notebook for several reasons. App. A6 (LF 105, ¶39(a)); Ex. A, p. 17.

First, the notebook did not record doughnut holes made. App. A6 (LF 105, ¶39(a)); Ex. A, p. 17.

According to the notebook, SEBA sold 1,045 dozen wholesale doughnuts in July 2015 at an average price of \$5.35 per dozen. The auditor determined that would have resulted in wholesale sales in the amount of \$5,590.75. “However, the wholesale sales per checks and credit card payments received totaled \$4,356.49,” while “the wholesale sales per guest checks totaled

\$3,990.05.” App. A6 (LF 105, ¶39(c)); Ex. A, p. 17. “SEBA’s records indicated retail sales of \$3,950.23.” App. A7 (LF 106, ¶39(d)).

Per the notebook, for the month of July 2015, SEBA made 768 dozen retail doughnuts, but sold 349.6 dozen retail doughnuts (11.3 dozen per day). App. A6 (LF 105, ¶39(d)); Ex. A, p. 58. SEBA claimed that it sold 349.6 dozen “and wasted 418.4 dozen.” App. A6 (LF 105, ¶39(d)); Ex. A, p. 58.

The auditor also concluded that she could not rely upon the information in the handwritten notebook because, if SEBA had sold 349.6 dozen retail doughnuts in July 2015, at the business’s retail prices of 75 cents per individual doughnut and \$8.00 per dozen, the dollar amount of July retail sales would have been between \$2,796.80 (349.6 dozen times \$8.00) and \$3,146.40 (349.6 [representing dozens sold] times twelve times \$0.75 per doughnut). App. A6-A7 (LF 105-106, ¶39(d)); Ex. A, p. 17. Instead, “SEBA’s records indicated retail sales of \$3,950.23.” App. A7 (LF 106, ¶39(d)); Ex. A, p. 17).

The auditor concluded that SEBA had provided her with fewer than one-third of the receipts generated for July 2015. App. A7 (LF 106, ¶39(e)); Ex. A, p. 17. Each receipt provided by SEBA bore a printed transaction number. App. A7 (LF 106, ¶39(e)).

The first receipt dated July 2, 2015³ at 8:43 a.m. was numbered 1512, and the last receipt provided was dated July 31, 2015 at 10:55 a.m. and numbered 3066. [The auditor] concluded that she should have received 1,555 (3066-5012) sales receipts from SEBA for July 2015 instead of 490.

App. A7 (LF 106, ¶39(e)). Arteaga told the auditor that Strickland would ring up an order twice if a customer wanted a receipt. App. A7 (LF 106, ¶39(e)); Ex.

³The doughnut shop was open seven days a week. TR at 15, l. 9-10. There was no evidence that it was closed on Wednesday, July 1, 2015.

A, p. 17. The auditor found that explanation inaccurate, “as over two thirds of the register receipts were missing.” App. A7 (LF 106, ¶39(e)); Ex. A, p. 17.

Because SEBA had no Z tapes, the auditor “asked SEBA to record each retail sale” for July 2015 “on a calculation tape... .” App. A6 (LF 105, ¶37, n. 8). “SEBA’s calculation tape did not match the combined total of cash register transaction receipts. Arteaga could not explain the discrepancy.” App. A7 (LF 106, ¶39(f)).

The auditor’s methodology

The auditor calculated the price of the average walk-in retail sale/ticket “by dividing the total payments received according to the receipts (\$3,950.23) by the count of receipts provided [for July 2015] (490).” Ex. A, p. 17; App. A6 (LF 105, ¶38). “The average ticket price for the 490 receipts was \$8.06.” App. A6 (LF 105, ¶38).

The auditor estimated SEBA’s retail sales for July 2015 by multiplying the average retail sale price per the 490 receipts that SEBA had provided for that month (\$8.06) by 1,555—the total number of July 2015 retail transactions for which the auditor concluded that SEBA should have provided her a receipt. App. A7 (LF 106, ¶43); Ex. A, p. 17; see App. A7 (LF 106, ¶39(e)), App. A6 (LF 105, ¶38). The auditor added that estimate of July 2015 retail sales with the amount of the check and credit card payments for wholesale orders for July 2015. App. A8 (LF 107, ¶44); Ex. A, p. 17. The auditor was able to verify SEBA’s wholesale doughnut sales, which were paid by check or credit card (see App. A4 (LF 103, ¶19), through bank statements. App. A7 (LF 106, ¶43, n. 12).

The auditor then determined the percentage of all July 2015 sales that were made by credit card, rather than cash or check. App. A8 (LF 107, ¶¶ 44-46). The auditor calculated SEBA’s “cash/credit ratio” for July 2015 by dividing the amount of “[c]redit card payments received per batch total” by total

estimated sales. Ex. A, p. 18; App. A8 (LF 107, ¶¶ 45, 46). The cash/credit ratio encompassed SEBA’s wholesale, as well as its retail, sales. App. A8 (LF 107, ¶¶ 46-48); Ex. A, pp. 17-18.

The auditor “then took the total credit card payments deposited during the audit period and divided by the 28% credit card ratio obtained from the July 2015 estimated sales to estimate gross sales for the audit period.” App. A8 (LF 107, ¶ 49); Ex. A, p. 18. The auditor added the total amount that customers paid for doughnut punch cards that were sold as a Groupon sale promotion⁴. App. A9 (LF 108, ¶¶ 51-53). Finally, the auditor deducted the amount of exempt sales that she had been able to verify (see App. A9 (LF 108, ¶¶ 54, 55)) “from the estimated gross sales to arrive at SEBA’s total estimated taxable sales for the audit period... [.]” App. A10 (LF 109, ¶ 57).

The auditor determined that SEBA had underreported a total of \$400,483.72 in sales for the audit period. App. A10 (LF 109, ¶ 58). This total consisted of (1) “the difference between what SEBA reported as exempt sales versus what Hoffman could verify as exempt sales[.]” \$127,543.81, and (2) \$272,939.91 in “additional taxable sales not reported by SEBA... [.]” App. A10 (LF 109, ¶ 58). SEBA did not present evidence of an alternative method that the auditor could have used to estimate SEBA’s gross receipts. App. A19 (LF 118).

Preparation of SEBA’s sales tax returns

“Arteaga determined which sales were wholesale versus retail in order to prepare [SEBA’s] sales tax returns by assuming the high dollar deposits were wholesale and low dollar deposits were retail sales.” App. A4 (LF 103, ¶ 25); see Ex. A, p. 18. This made the Commission “question whether SEBA

⁴ SEBA has not contested the auditor’s decision to add \$6,700.73, representing the amount customers paid for the Groupon doughnut punch cards (App. A9 (LF 108, ¶¶ 51-53)), to its taxable sales.

ever retained its wholesale invoices in a metal desk, as this would have been a more accurate method to distinguish between its retail and wholesale sales.” App. A4 (LF 103, ¶25 n. 6).

SEBA used a professional bookkeeper, Joe Otten, to prepare its sales tax returns. App. A4 (LF 103, ¶24). Otten stopped providing services to SEBA when Arteaga sold his interest in SEBA to Eddie Strickland. TR at 58, l. 10-17. “Arteaga provided Otten copies of SEBA’s bank and credit card statements and check stubs for expenses paid[]” every three months. App. A4 (LF 103, ¶25).

Otten “used the bank statements” to prepare SEBA’s sales tax returns. TR at 59, l. 1-4. He had advised Arteaga to create a separate business bank account for SEBA. TR at 59, l. 4-17. “Otten reviewed the credit card statements to ensure they matched up with the bank statements.” App. A4 (LF 103, ¶26). “Otten relied upon the cash deposits listed on the bank statements. Otten had no way to verify if all cash was deposited into SEBA’s bank account, but he had no reason to suspect it had not been.” App. A5 (LF 104, ¶27).

Otten never saw any Z tapes from SEBA. TR at 64, l. 9-10. He counsels his business clients to keep Z tapes. TR at 64, l. 11-15. Some of Otten’s business customers provide him with Z tapes “or some printed record that shows... how many sales were made.” TR at 64, l. 16-23.

Exempt sales

“Because SEBA did not retain documentation of its exempt sales, [the auditor] calculated the total valid exempt sales amount based on a review of the exemption letters Arteaga obtained from his customers and SEBA’s other verified exempt sales.” App. A9 (LF 108, ¶54). The auditor “determined that SEBA had only exempt sales of \$12,678.26, and had otherwise over-reported its exempt sales for the audit period.” App. A9 (LF 108, ¶55). The auditor “did

not include as exempt customers Exclusive Catering, St. Patrick Center, Phillips 66, Water Auto Centers, St. John the Baptist Catholic Church, and Emmanuel Episcopal Church because SEBA did not provide her with exemption letters for these entities.” App. A9 (LF 108, ¶55). See TR at 79, l. 13-20 (no tax exempt certificate or letter provided for St. Patrick Center). “The record does not contain evidence that the St. Patrick Center is part of the Archdiocese of St. Louis.” App. A10 (LF 109, ¶56).

The Official Catholic Directory was not in evidence. App. A21-A22 (LF 120-21). It was mentioned very briefly during the auditor’s cross-examination:

SEBA’s attorney: And you didn’t do maybe a little bit of homework to say, oh, in the book it says these are the entities from the Catholic churches?

Witness: Which book? I didn’t—

SEBA’s attorney: The book that’s referenced on the first page there.

Witness: The book that’s referenced on the first page.

SEBA’s attorney: Yes.

Witness: Of Exhibit 13?

SEBA’s attorney: Yes, of Exhibit 13.

Witness: No. I did not look at the official Catholic directory.

TR at 105, l. 12-14, l. 23 through p. 106, l. 7.

The first page of Exhibit 13 appears to be a December 13, 2008, memo from the St. Louis Archdiocese’s Chief Financial Officer to “All Archdiocesan Parishes, Offices, and Agencies.” Ex. 13, p. 1. The memo states that

... all organizations of the Archdiocese of St. Louis which are listed in The Official Catholic Directory are permitted to use the Missouri Sales/Use Tax Exemption letter issued to the Archdiocese of St. Louis by the Missouri Department of Revenue.

It is the suggestion of the representative of the Missouri Taxation Bureau that, when using the letter issued to the Archdiocese of St. Louis *effective* July 11, 2002, it be accompanied by the letter dated October 16, 2008, along with the dated cover page of The Official Catholic Directory and the appropriate page from that Directory which lists the organization.

Ex. 13, p. 1.

Page 2 of Exhibit 13 is an October 16, 2008, letter from the Missouri Department of Revenue, Taxation Bureau. Ex. 13, p. 2. It is “an informational letter only, not a binding letter ruling.” Ex. 13, p. 2. The letter includes the following statements:

Dear Sir or Madam:

The purpose of this letter is to confirm that organizations listed in the Official Catholic Directory, under the Archdiocese of St. Louis, are agents and instrumentalities of the Archdiocese, and therefore, these organizations are permitted to use the Missouri Sales/Use Tax Exemption Letter, issued to the Archdiocese of St. Louis, by the Missouri Department of Revenue.

The Archdiocese of St. Louis is required to furnish the Missouri Department of Revenue with current copies of the Official Catholic Directory, to ensure that the department has updated records of the agents and instrumentalities in use of the exemption letter.

This is an informational letter only, not a binding letter ruling. The information in this letter is intended to provide you with guidance on the possible tax consequences of the specific facts you have presented. ... You are advised that the Department may take a position different from the one stated in this letter without additional notice to you. To request a binding letter ruling see Regulation 12 CSR 10-1.020.

Ex. 13, p. 2.

The Director's assessments

After applying a two percent discount (App. A11 (LF 110, ¶61); Ex. A, p. 15), the Director issued an assessment for unpaid sales tax for the audit period in the amount of \$34,313.87, plus \$1,715.70 in additions to tax, and interest in the amount of \$2,510.87 as of January 1, 2016, for a total amount of \$38,540.44. App. A11 (LF 110, ¶61). Ex. A, pp. 15, 21. The auditor determined that SEBA had underpaid sales tax due in the amount of \$26,207.50 because it had underreported sales on its returns. App. A11 (LF 110, ¶61). Disallowed exempt sales resulted in “an underpayment of sales tax in the amount of \$12,332.94.” App. A11 (LF 110, ¶61).

SEBA appealed the assessment. App. A1; see LF 2-96 (AHC Complaint with exhibits). The Commission held a hearing. See TR; App. A1.

The Commission found that SEBA had established through Exhibit 13 that sales to Emmanuel Episcopal Church, Phillips 66 Station, and 7-Eleven were exempt. App. A22 (LF 121). The Commission found that Exhibit 13 established that Emmanuel Episcopal Church “purchased \$2,204 in donuts from SEBA during the audit period.” App. A22 (LF 121). Based on Exhibit 13, the Commission also found that donut purchases were made by Phillips 66 Station in the amount of \$12,318.57, and by 7-Eleven in the amount of \$9,360. App. A22 (LF 121). Therefore, the Commission found that “SEBA has established that it does not owe sales tax on \$26,567.57 in exempt sales contrary to the Director’s conclusions and assessments.” App. A22 (LF 121).

The Commission issued its decision finding SEBA “liable for unpaid sales tax in the amount of \$38,540.44, minus the sales tax assessed on \$26,567.57 in income generated from SEBA’s exempt sales.” App. A23 (LF 122). The Commission further concluded that SEBA “is also liable for additions to sales tax owed and statutory interest.” App. A23 (LF 122).

SEBA filed a petition for review in the Missouri Court of Appeals, Western District. After briefing and oral argument, the Court of Appeals transferred this case.

ARGUMENT

Standard of Review

A decision of the Administrative Hearing Commission must be affirmed if “(1) it is authorized by law; (2) it is supported by competent and substantial evidence on the whole record; (3) mandatory procedural safeguards are not violated; and (4) it is not clearly contrary to the reasonable expectations of the General Assembly.” *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 435-36 (Mo. banc 2010); Section 621.193, RSMo. The Commission’s factual determinations “will be upheld if supported by substantial evidence based on review of the whole record.” *Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118, 121 (Mo. banc 2014). “Substantial evidence” is “evidence which has probative force on the issues, and from which the trier of facts can reasonably decide the case.” *Lagud v. Kansas City Bd. of Police Comm’rs*, 272 S.W.3d 285, 290 (Mo. App. W.D. 2008) (quoting cases) (internal quotation marks omitted).

This Court will review the record as a whole in determining whether the Commission’s decision is supported by competent and substantial evidence and “ ‘determine whether the AHC’s decision is against the overwhelming weight of the evidence.’ ” *Schrock v. Gan*, 563 S.W.3d 127, 130 (Mo. App. W.D. 2018) (quoting cases). This Court “must defer” to the Commission’s credibility findings, as the Commission “is the sole judge of the credibility of witnesses and the weight and value to give to the evidence.” *Id.*

This Court reviews the Commission’s interpretation of revenue statutes de novo. *Brinker Mo., Inc.*, 433 S.W.3d at 435. Exemptions are strictly construed against the taxpayer, “and any doubt must be resolved in favor of application of the tax.” *Bartlett Int’l, Inc. v. Dir. of Revenue*, 487 S.W.3d 470, 472 (Mo. banc 2016). “An exemption is allowed only upon clear and unequivocal proof, and any doubts are resolved against the party claiming it.” *Id.*

Introduction

As required by statute, the Department of Revenue's auditor estimated SEBA's gross receipts based upon information available to her, §144.250.4, which included financial records for SEBA's business. The auditor's methodology was reasonable and supported by competent and substantial evidence. Substantial and competent evidence on the whole record supports the Commission's finding that SEBA lacked adequate records of its transactions for the audit period (and in general).

SEBA failed to meet its burden of establishing that sales to the St. Patrick Center or St. John the Baptist Catholic Church were exempt. The Official Catholic Directory was not offered, and SEBA did not ask the Commission to take official notice, or judicial notice, of the Official Catholic Directory. SEBA did not establish that a copy of the Official Catholic Directory was contained in the records of the Missouri Department of Revenue.

- I. Substantial and competent evidence established that SEBA underreported its sales, resulting in liability for unpaid sales tax. (Responds to Point I)**
- A. The Commission correctly determined that SEBA had the burden of proof under §136.300.1, RSMo, because competent and substantial evidence supported the Commission's finding that SEBA had inadequate records of its transactions.**

As a general rule, the burden is on the Director of Revenue "to show a tax liability." *Cook Tractor Co., Inc. v. Director of Revenue*, 187 S.W.3d 870, 872 (Mo. banc 2006), citing *Six Flags Theme Parks, Inc. v. Dir. of Revenue*, 102 S.W.3d 526, 529 (Mo. banc 2003). But the general rule does not apply here. Section 136.300.1 governs the burden of proof with respect to SEBA, LLC's sales tax liability for the audit period. App. A12 (LF 111); Section 136.300.1, RSMo. The statute provides in pertinent part that

.... The director of revenue shall have the burden of proof with respect to any factual issue relevant to ascertaining the liability of a taxpayer only if:

- (1) The taxpayer has produced evidence that establishes that there is a reasonable dispute with respect to the issue; and
- (2) The taxpayer has adequate records of its transactions and provides the department of revenue reasonable access to these records.

Section 136.300.1, RSMo.

Persons engaged in business and subject to Missouri's Sales Tax Law must keep books and records as required by the Secretary of the Treasury under title 26 of the United State Code "for federal income tax purposes[.]" *see* 26 U.S.C. §6001; 26 U.S.C. §7701(11); Section 144.320, RSMo. The taxpayer

shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return... ."

26 C.F.R. §1.6001-1(a). In determining the amount of tax due, or whether a return is correct, the Director of Revenue "may examine any books, papers, records or memoranda of any taxpayer bearing upon such sales by any such person," and "may hold investigations" concerning any matters covered by the Sales Tax Law (*see* §144.010.3); Section 144.330, RSMo.

The letter notifying SEBA of the Missouri Department of Revenue's audit requested documents and records including sales tax returns and schedules, sales journals, sales invoices, sales tax exemption certificates and letters, detailed general ledger, purchase invoices, 1099-K forms, and bank statements. Ex. A, p. 71; *see* App. A5 (LF 104, ¶28). Two weeks later, the auditor sent a letter to Arteaga, SEBA's majority owner, directing him to "maintain appropriate books and records" for the business on a going forward

basis, including “detailed sales invoices, tickets, z-tapes and/or register receipts to support all sales transactions.” Ex. A, p. 73. As discussed in detail below, SEBA failed to maintain adequate records of its sales, before and after the pre-audit correspondence from the auditor, and failed to provide adequate records to the Department of Revenue.

The Commission’s finding that “... SEBA did not have adequate records of its transactions[]” (App. A12 (LF 111)) was supported by competent and substantial evidence. As a result, SEBA had the burden of proof with respect to its sales tax liability. Section 136.300.1(2), RSMo.

The Commission found that “SEBA did not have individual sales receipts for the audit period, and it had insufficient records to back up its bank deposits.” App. A12 (LF 111). SEBA’s cash register only printed a single receipt for each sale. App. A3 (LF 102, ¶15). SEBA’s business practice was to throw a receipt away if a customer did not want it. App. A3 (LF 102, ¶16). The cash register did not generate Z tapes (App. A3 (LF 102, ¶17; Ex. A, pp. 17, 19). Z tapes “record daily sales” from a cash register. *Garfield Mart, Inc. v. Dept. of Treasury*, 907 N.W.2d 880, 883 (Mich. Ct. App. 2017). SEBA had no “secondary method to track sales.” App. A3 (LF 102, ¶17). SEBA “chose not to have a method by which it documented its sales.” App. A18 (LF 117).

The Commission found that “SEBA failed to maintain adequate business records... .” App. A12 (LF 111). SEBA “did not have inventory numbers establishing the number of donuts and donut holes made and sold and the number of drinks sold during the audit period.” App. A12 (LF 111).

Ample evidence supported the Commission’s conclusion that SEBA produced “insufficient and inconsistent records... during the audit.” App. A18 (LF 117). The auditor afforded SEBA opportunities to document its sales, including exempt sales (App. A5 (LF 104, ¶34), App. A9 (LF 108, ¶54); Ex. A,

p. 18), “and production numbers after the fact, but SEBA still provided inconsistent and incomplete data.” App. A18 (LF 117); see Ex. A, pp. 17-19.

SEBA did not provide all business records requested by the Department’s auditor. App. A5-A6 (LF 104, ¶¶28, 32, 34, 35), App. A9 (LF 108, ¶¶54, 55), App. A12 (LF 111); Ex. A, pp. 16-18; TR at 69, l. 5-16. The records that SEBA provided to the auditor were not complete. TR at 69, l. 11-19; Ex. A, pp. 16, 17.

SEBA lacked records of individual credit card sales. “Instead, the credit card machine printed a piece of paper with the batch total of the sales for the day.” App. A4 (LF 103, ¶18). 1099-K forms were not provided for the full audit period. Ex. A, pp. 16, 18; App. A5 (LF 104, ¶34); TR at 69, l. 11-16. A 1099-K form shows the gross amount of credit card transactions for a calendar year on a monthly and an annual basis. *See* 26 C.F.R. §1.6050W-1(a)(5)(i)(A), (h)(2).

Arteaga claimed that he had stored SEBA’s business records, including all documents that the auditor had requested, inside a metal desk (see Ex. 10, p. 71; TR at 49, l. 16 through p. 50, l. 5), in a room that he had rented to an unnamed tenant (TR at 19, l. 8-13; see App. A4 (LF 103, ¶23)). The Commission questioned “whether SEBA ever retained its invoices in a metal desk,” App. A4 (LF 103, ¶25 n. 6), because “Arteaga determined which sales were wholesale versus retail in order to prepare the sales tax returns by assuming the high dollar deposits were wholesale and low dollar deposits were retail sales.” App. A4 (LF 103, ¶25, n. 6); see Ex. A, p. 18.

During the audit, “[b]ecause SEBA had limited documentation of its retail sales, [the auditor] asked SEBA to retain the individual cash register receipts for December 2014, with the beginning and ending inventory of donuts made in the shop for the month.” App. A5-A6 (LF 104-105, ¶35); Ex. A, p. 17. It is undisputed that “the taxpayer only provided individual receipts for 2 days

during the month.” Ex. A, p. 17. The auditor also found that “[t]here were missing batch totals during the month” of December 2014. Ex. A, p. 17.

After having received insufficient sales records for December 2014, the auditor requested SEBA’s sales records for the April 2015 through June 2015 quarterly filing period, “but SEBA did not retain the requested records.” App. A6 (LF 105, ¶36), A12 (LF 111); Ex. A, p. 17.

SEBA provided incomplete and inadequate records of its July 2015 retail sales.

Due to SEBA’s failure to comply with its legal obligation to retain sales records for the April to June 2015 quarter, *see* §144.320 (business’s “books and records shall be preserved for a period of at least three years...”); *see* App. A6 (LF 105, ¶36), A12 (LF 111), the auditor “requested sales documentation for July 2015.” Ex. A, p. 17; *see* App. A6 (LF 105, ¶37).

The auditor concluded that SEBA had provided her with fewer than one-third of the receipts generated for July 2015. App. A7 (LF 106, ¶39(e)); Ex. A, p. 17. The Commission found that conclusion reasonable. App. A18 (LF 117).

Each receipt provided by SEBA bore a printed transaction number. App. A7 (LF 106, ¶39(e)).

The first receipt dated July 2, 2015⁵ at 8:43 a.m. was numbered 1512, and the last receipt provided was dated July 31, 2015 at 10:55 a.m. and numbered 3066. [The auditor] concluded that she should have received 1,555 (3066-5012) sales receipts from SEBA for July 2015 instead of 490.

App. A7 (LF 106, ¶39(e)). Arteaga told the auditor that Strickland would ring up an order twice if a customer wanted a receipt. App. A7 (LF 106, ¶39(e)); Ex.

⁵The doughnut shop was open seven days a week. TR at 15, l. 9-10. There was no evidence that it was closed on Wednesday, July 1, 2015.

A, p. 17. The auditor found that explanation inaccurate, “as over two thirds of the register receipts were missing.” App. A7 (LF 106, ¶39(e)); Ex. A, p. 17.

SEBA’s cash register could not generate Z tapes. App. A3 (LF 102 ¶17); Ex. A, pp. 17, 19. The auditor “asked SEBA to record each retail sale on a calculation tape... .” App. A6 (LF 105 ¶37, n. 8); see Ex. A, p. 17. “SEBA’s calculation tape did not match the combined total of cash register transaction receipts. Arteaga could not explain the discrepancy.” App. A7 (LF 106, ¶39(f)); see Ex. A, p. 17.

B. The auditor’s estimate methodology and reconstruction of SEBA’s gross receipts was based on competent and substantial evidence.

The auditor concluded that SEBA was underreporting its sales. App. A10 (LF 109, ¶59); Ex. A, pp. 15, 19-21. Due to the many missing receipts for July 2015, she concluded that not all cash was being deposited in SEBA’s bank account. App. A7 (LF 106, ¶40); Ex. A, pp. 17, 18, 20.

1. Section 144.250.4 required the auditor to estimate SEBA’s gross receipts.

Under the circumstances, the auditor was required to make an estimate of SEBA’s gross receipts, and sales taxes that SEBA owed, but had failed to remit. *See* Section 144.250.4, RSMo.

... [I]f a person neglects or refuses to make a return **and payment** as required by sections 144.010 to 144.525, the director of revenue **shall make an estimate based upon any information** in his possession or that may come into his possession of the amount of the gross receipts of the delinquent for the period in respect to which he failed to make return and payment, and upon the basis of said estimated amount compute and assess the tax payable by the delinquent; such estimate may be reconstructed for that period of time for which the tax may be collected as prescribed by law.

Section 144.250.4, RSMo. (emphasis added). The Commission concluded, from the language of the statute, that “the Director and his auditors do not need to conduct any kind of extensive, independent search to find all possible information.” App. A13 (LF 112).

The undersigned knows of no reported opinion addressing director of revenue estimates or estimate methodology under §144.250.4. The Commission discussed this Court’s opinion addressing a flawed estimate and assessment under a predecessor statute, §11426 (1945), *State ex rel. DeWeese v. Morris*, 221 S.W.2d 206 (Mo. 1949). See App. A13 (LF 112). In *DeWeese*, the auditor did not use any direct information about the taxpayer’s business operations, rather, the auditor based his conclusions upon information and records of prior and subsequent owners of the business, and non-testimonial statements of third parties that the café was “ ‘the best place in town to eat.’ ” 221 S.W.2d at 207-209. He had no information about how much business taxpayer did. *Id.* at 209. That auditor apparently failed to consider that taxpayer, unlike predecessor and successor owners, did not operate the café on Sundays. *Id.* There was “no evidence of probative value” that the taxpayer’s “sales approximated those of his predecessor or successor.” *Id.*

In contrast, here the auditor “ ‘calculated SEBA’s taxable retail income based on its financial records and register receipts.’ ” App. A17 (LF 116). The Commission found “ ‘this approach reasonable based on the record before us.’ ” App. A17 (LF 116).

The Commission also considered a case in which this Court found that, for income tax purposes, a business was entitled to the application of a statutory apportionment formula for sales that were “partly within and partly without Missouri.” See App. A14 (LF 113); *Dick Proctor Imports, Inc. v. Dir. of Revenue*, 746 S.W.2d 571, 572, 575 (Mo. banc 1988). In *Dick Proctor*, the

Commission had failed to apply the statutory formula to any of the business's sales. 746 S.W.2d at 575. The Court found that the evidence "did not establish the precise amount" of sales that were within and without Missouri, but unequivocally established that a large amount of reported sales were, in fact, "transactions partly within and partly without Missouri... ." *Dick Proctor*, 746 S.W.2d at 575.

The parties would have the opportunity to present additional evidence to the Commission concerning "the exact nature and amount" of the business's sales. *Id.* If "the precise amount" of sales that were partly within and partly without Missouri remained uncertain, the Commission was to "make as close an approximation as it can. Doubt may be resolved against appellant at whose door the uncertainty can be laid." *Dick Proctor*, 746 S.W.2d at 575.

In determining the amount of SEBA's sales, the Commission determined that it should apply this Court's guidance in *Dick Proctor* as SEBA's inadequate records of its sales did not allow the Commission to calculate SEBA's taxable sales with certainty. App. A12, A14 (LF 111, 113).

2. This Court should uphold the Commission's finding that the auditor's methodology was reasonable and based on competent and substantial evidence.

The Commission correctly found that the auditor's calculations and estimate of SEBA's sales, (App. A13, A18 (LF 112, 117)), and her methodology (App. A17 (LF 116)), were based on competent and substantial evidence. The evidence supporting the auditor's calculations and estimate included her examination of SEBA's own "financial records and receipts." See App. A17 (LF 116); see *State ex rel. Sure-Way Transp., Inc. v. Div. of Transp., Dept. of Econ. Dev.*, 836 S.W.2d 23, 26 (Mo. App. W.D. 1992) (business records and auditor's testimony concerning his examination of business's financial records were competent and substantial evidence to support administrative law judge's

finding). The Commission's determination of SEBA's tax liability, based upon the auditor's estimate and calculations, was not against the overwhelming weight of the evidence.

SEBA's records of doughnuts made and sold were unreliable.

One item that SEBA provided to the auditor after she requested sales documentation for July 2015 was a notebook prepared by Strickland "containing handwritten entries of its reported number of donuts made for wholesale and retail, donuts sold at retail, and donuts thrown away as waste." App. A6 (LF 105, ¶37); see Ex. A, pp. 17, 58; see TR at 25, l. 18-19, p. 26, l. 2-8, p. 69, l. 20-25. "The notebook was created while SEBA was being audited, and it contained inconsistencies." App. A16 (LF 115).

The Commission "agree[d] with the auditor that she lacked credible data to estimate SEBA's taxable retail sales based upon the number of donuts SEBA made and sold during the audit period." App. A17 (LF 116). The Commission found that "SEBA was reluctant to provide the auditor with documentation, and it only provided the notebook after it failed to comply with two previous requests by the auditor." App. A16 (LF 115).

Arteaga claimed that he no longer had the notebook at the time of the hearing because he could not remember where in his photography studio he had put it. TR at 25, l. 18 through p. 26, l. 1; see App. A6 (LF 105, ¶37, n. 7).

After reviewing all records that SEBA had provided to her for July 2015, the auditor concluded in her report that she could not rely upon the handwritten records in the notebook for several reasons. App. A6 (LF 105, ¶39(a)); Ex. A, p. 17. First, the notebook did not record doughnut holes made. App. A6 (LF 105, ¶39(a)); Ex. A, p. 17. The Commission did not find Arteaga's testimony that SEBA did not sell doughnut holes, and only gave them out as samples, credible. App. A3 (LF 102, ¶14, n. 5). The Commission based that

credibility determination upon evidence contained in SEBA's Exhibits 8 and 13, and the auditor's testimony that she had seen doughnut holes in the display case in SEBA's shop. App. A3 (LF 102, ¶14, n. 5); see TR at 87, l. 2-6 (auditor testimony).

According to the notebook, SEBA sold 1,045 dozen wholesale doughnuts in July 2015 at an average price of \$5.35 per dozen. The auditor determined that would have resulted in wholesale sales in the amount of \$5,590.75. "However, the wholesale sales per checks and credit card payments received totaled \$4,356.49," while "the wholesale sales per guest checks totaled \$3,990.05." App. A6 (LF 105, ¶39(c)); Ex. A, p. 17.

SEBA's doughnut shop had been in operation at the same location since February 2007. App. A2 (LF 101, ¶1). Per the notebook, for the month of July 2015, SEBA made 768 dozen retail doughnuts, but sold 349.6 dozen retail doughnuts (11.3 dozen per day). App. A6 (LF 105, ¶39(d)); Ex. A, p. 58. SEBA claimed that it sold 349.6 dozen "and wasted 418.4 dozen." App. A6 (LF 105, ¶39(d)); Ex. A, p. 58. The Commission did not find it credible "that SEBA made 768 dozen retail doughnuts in July 2015, but wasted 418.4 dozen." App. A16 (LF 115). Commission stated that "[w]e find it unreasonable that SEBA would waste more of its product than it sold." App. A16 (LF 115).

The auditor also concluded that she could not rely upon the information in the handwritten notebook because, if SEBA had sold 349.6 dozen retail doughnuts in July 2015, at the business's retail prices of 75 cents per individual doughnut and \$8.00 per dozen, the dollar amount of July retail sales should have been between \$2,796.80 (349.6 dozen times \$8.00) and \$3,146.40 (349.6 [representing dozens sold] times twelve times \$0.75 per doughnut). App. A6-A7 (LF 105-106, ¶39(d)); Ex. A, p. 17. Instead, "SEBA's records indicated retail sales of \$3,950.23." App. A7 (LF 106, ¶39(d)); Ex. A, p. 17).

Contrary to SEBA's assertion (see App.'s Subst. Br. at 41, 42), the auditor *did not* find that SEBA's actual retail sales for July 2015 "should have been between \$2,796.80 (349.6 dozen times \$8.00) and \$3,146.40 (349.6 [representing dozens sold] times twelve times \$0.75 per doughnut)." See App. A6-A8 (LF 105-106, ¶¶39(d), 43, 44); Ex. A, p. 17. For the reasons explained above, the auditor concluded that she could not rely upon the handwritten notebook. App. A6-A7 (LF 105-106, ¶¶39(a), (d)); Ex. A, p. 17; see *supra* 33-34. SEBA underreported its retail sales.

The auditor's methodology

The auditor estimated SEBA's retail sales for July 2015 by multiplying the average retail sale price per the 490 receipts that SEBA had provided for that month (\$8.06) by 1,555—the total number of July 2015 retail transactions for which SEBA should have provided a receipt to the auditor. App. A7 (LF 106, ¶43); Ex. A, p. 17; see App. A7 (LF 106, ¶39(e)), App. A6 (LF 105, ¶38). The auditor added that estimate of July 2015 retail sales with the amount of the check and credit card payments for wholesale orders for July 2015. App. A8 (LF 107, ¶44); Ex. A, p. 17. The auditor was able to verify SEBA's wholesale doughnut sales, which were paid by check or credit card, through bank statements. App. A7 (LF 106, ¶43, n. 12).

Then the auditor determined the percentage of all July 2015 sales that were made by credit card, rather than cash or check. App. A8 (LF 107, ¶¶ 44-46). The auditor calculated SEBA's "cash/credit ratio" for July 2015 by dividing the amount of "[c]redit card payments received per batch total" by total estimated sales. Ex. A, p. 18; App. A8 (LF 107, ¶¶ 45, 46).

The auditor "then took the total credit card payments deposited during the audit period and divided by the 28% credit card ratio obtained from the July 2015 estimated sales to estimate gross sales for the audit period." App. A8

(LF 107, ¶49); Ex. A, p. 18. The auditor added the total amount that customers paid for doughnut punch cards that were sold as a Groupon sale promotion⁶. App. A9 (LF 108, ¶¶51-53). Finally, the auditor deducted the amount of exempt sales that she had been able to verify (see App. A9 (LF 108, ¶¶54, 55)) “from the estimated gross sales to arrive at SEBA’s total estimated taxable sales for the audit period... [.]” App. A10 (LF 109, ¶57).

The auditor determined that SEBA had underreported a total of \$400,483.72 in sales for the audit period. App. A10 (LF 109, ¶58). This consisted of (1) “the difference between what SEBA reported as exempt sales versus what Hoffman could verify as exempt sales[.]” \$127,543.81, and (2) \$272,939.91 in “additional taxable sales not reported by SEBA... [.]” App. A10 (LF 109, ¶58).

“ ‘The existence of unreported income may be demonstrated by any practicable proof that is available in the circumstances of the particular situation.’ ” *Campbell v. Guetersloh*, 287 F.2d 878, 880 (5th Cir. 1961) (internal punctuation omitted), *quoting Davis v. United States*, 226 F.2d 331, 336 (6th Cir. 1955). A business’s “books and records may support the tax return as filed yet omit taxable income.” *Diesel Country Truck Stop, Inc. v. Comm’r of Internal Revenue Serv.*, 80 TCM (CCH) 494, 2000 WL 1478654 at *6 (T.C. 2000).

When the Director of Revenue is required to estimate a taxpayer’s gross receipts, *see* §144.250.4, RSMo, “such estimate may be **reconstructed** for that period of time for which the tax may be collected as prescribed by law.” Section 144.250.4, RSMo (emphasis added). Like the Commissioner of the Internal Revenue Service, the Missouri Director of Revenue should be given “latitude in determining which method of reconstruction to apply when taxpayers fail to

⁶ SEBA does not contest the auditor’s decision to add \$6,700.73, representing the amount customers paid for the Groupon doughnut punch cards, to its taxable sales.

maintain adequate records[.]” *Diesel Country Truck Stop, Inc.*, 80 TCM (CCH) 494, 2000 WL 1478654 at *7. SEBA failed to present any evidence of an alternative method that the Director of Revenue’s auditor could have used to estimate its gross receipts. App. A19 (LF 118). With respect to the auditor’s methodology, the Commission stated, “We do not find that the method the auditor used was unreasonable or not based on competent and substantial evidence.” App. A19 (LF 118).

SEBA has not shown that the evidence favorable to the Commission’s decision and the auditor’s findings lacks probative value.

“Substantial evidence” is “evidence which has probative force on the issues, and from which the trier of facts can reasonably decide the case.” *Lagud*, 272 S.W.3d at 290. SEBA appears to question three factual findings related to the audit, but has failed to demonstrate that all of the evidence favorable to the Commission’s decision, considered with reasonable inferences drawn from that evidence, “does not have probative force upon the proposition such that the trier of fact could not reasonably decide the existence of the proposition.” See *Missouri-Amer. Water Co. v. Pub. Serv. Comm’n*, 591 S.W.3d 465, 470 n. 2 (Mo. App. W.D. 2019), quoting *Houston v. Crider*, 317 S.W.3d 178, 187 (Mo. App. S.D. 2010). Thus, SEBA has not shown that the Commission’s decision, or the auditor’s methodology and estimate of SEBA’s tax liability, were not supported by substantial evidence. *Id.*

Average retail sale

On appeal, SEBA contended that the auditor made three erroneous assumptions in estimating its taxable sales. The first alleged “erroneous assumption” (see App.’s Subst. Br. at 45) was no assumption. Rather, the auditor calculated the average ticket or walk-in retail sale price of \$8.06 “by dividing the total payments received according to the receipts (\$3,950.23) by

the count of receipts provided [for July 2015] (490).” Ex. A, p. 17; App. A6 (LF 105, ¶38).

The Commission accepted the auditor’s method of calculating the average retail sale, which was based on competent and substantial evidence—“she used the very records SEBA provided to her.” App. A17-A18 (LF 116-17). The auditor’s calculation of the average retail sale price was an estimate that may or may not have matched the actual average retail sale amount for July 2015—but that was SEBA’s fault, because SEBA failed to provide more than two-thirds of its receipts for July 2015 to the auditor. App. A7 (LF 106, ¶39(e)); App. A17 (LF 116), A18 (LF 117); see TR at 100, l. 21-25. SEBA had the burden of proof because of its inadequate records of transactions. Section 136.300.1(2), RSMo.

The Commission found that the average retail sale amount for July 2015 was \$8.06. App. A6 (LF 105, ¶38), see App. A7 (LF 106, ¶43). The auditor’s calculation of the average retail sale was based on competent and substantial evidence—objective mathematical calculations from the receipts that SEBA provided. App. A18 (LF 117), App. A6 (LF 105, ¶38); see *Mo. Nat’l Educ Ass’n v. Mo. St. Bd. of Educ.*, 34 S.W.3d 266, 281 (Mo. App. W.D. 2000). Therefore, this Court should reject any suggestion that the Commission’s finding that the average retail sale amount for July 2015 was \$8.06 was an unreasonable or arbitrary finding. See App.’s Subst. Br. at 49.

Arteaga claimed that the average walk-in purchase consisted of “a couple donuts and a cup of coffee” (TR at 19, l. 20 through p. 20, l. 1), which cost “less than \$3.” TR at 35, l. 15-18. But, before SEBA’s attorney could ask Arteaga another question, Arteaga contradicted his own testimony by adding, “We would make one pot of coffee a day, and... Eddie probably had half of that... Our coffee sales were horrible.” TR at 20, l. 5-8. Arteaga’s contradictory

testimony “does not constitute substantial evidence.” *Lagud*, 272 S.W.3d at 290.

Overall, the Commission “gave Arteaga’s testimony limited weight because, at times, he lacked credibility and his testimony was inconsistent with other evidence in the record as discussed in our conclusions of law.” App. A2 (LF 101, ¶4, n. 3). The average retail sale price was disputed. The Commission was free to disbelieve Arteaga’s testimony on disputed matters. *Lagud*, 272 S.W.3d at 292.

SEBA complained that the auditor did not break the \$3,950 total of the 490 receipts that SEBA provided for July 2015 into total cash versus total credit card sales. App. A18-19 (LF 117-18); see App.’s Br. at 37). The Commission found that the auditor “did calculate SEBA’s retail cash sales independent of its retail credit card sales.” App. A19 (LF 118).

SEBA suggests that the auditor should have analyzed the 490 receipts provided for July 2015 individually “to see if they showed any specific regularities, purchase patterns or abnormalities.” App.’s Subst. Br. at 47-48. As shown by the page of the transcript cited by SEBA, the auditor did not understand the question posed to her (TR at 97, l. 3-6), so she did not answer it. TR at 97, l. 3-14).

The Commission addressed SEBA’s argument that the auditor should have calculated average sales for each day from the 490 receipts provided for July 2015. App. A18 (LF 117). The Commission stated

We cannot find from the record that the auditor’s method of calculating the average sale was not based on competent and substantial evidence because she used the very records SEBA provided to her. Her calculations were based upon a reasonable probability given the information with which she had to work.

App. A18 (LF 117)

The auditor's testimony at pages 99-100 of the transcript does not establish that she was required to use "a different methodology" to determine average cash retail sales for July 2015, see App.'s Subst. Br. at 48. SEBA's attorney asked the auditor whether totaling "the actual cash receipts" and dividing that "by however many cash receipts they were[,] " wouldn't "have been a better way of determining the cash receipts... ." TR at 99, l. 20-23⁷. The auditor answered, "I don't know that because not all the receipts were provided to me." TR at 100, l. 2-3. The Commission found the auditor's conclusion that SEBA only produced 490 out of 1,555 receipts generated in July 2015 (App. A7 (LF 106, ¶39(e)); Ex. A, p. 17) "reasonable in light of the insufficient and inconsistent records SEBA produced during the audit." App. A18 (LF 117); App. A7 (LF 106, ¶39(e)).

The Commission did not err in adopting the auditor's estimate of SEBA's July 2015 retail and wholesale sales.

SEBA suggests that the Commission erred in accepting the auditor's estimate that its July 2015 retail sales were \$12,535.93 and the auditor's determination that SEBA's July 2015 wholesale sales were \$4,356.49 (App. A8 (LF 107), ¶44⁸). App.'s Subst. Br. at 51. SEBA contends that the Commission's adoption of the auditor's estimate of SEBA's retail sales was "refuted" by Arteaga's testimony "regarding Eddie's wholesale/retail sales ratio." App.'s Subst. Br. at 51. SEBA is mistaken.

⁷ The assertion of SEBA's attorney, embedded in his question at page 99, line 20 through page 100, line 1 of the transcript, does not establish that "credit card receipts were likely to include higher sales amounts than cash receipts." See App.'s Subst. Br. at 48.

⁸ The auditor calculated SEBA's "total estimated gross sales for the month of July 2015 at \$16,982.42." App. A8 (LF 107, ¶44). \$16,982.42 minus the estimated retail sales of \$12,535.93 (App. A8 (LF 107, ¶44)) equals \$4,356.49.

Arteaga’s testimony that “probably” 80 percent was “more of the wholesale side than walk-in [i.e., retail] []” during the audit period (TR at 18, l. 13-17); see App.’s Subst. Br. at 51, is not probative or substantial evidence of the wholesale versus retail percentages of SEBA’s sales. See *Tuf Flight Indus., Inc. v. Harris*, 129 S.W.3d 486, 491 (Mo. App. W.D. 2004). The Commission found that “Arteaga determined which sales were wholesale versus retail in order to prepare [SEBA’s] sales tax returns by assuming the high dollar deposits were wholesale and low dollar deposits were retail sales.” App. A4 (LF 103, ¶25); see Ex. A, p. 18. Arteaga’s approach to deciding which sales were wholesale was inaccurate.

Overall, the Commission “gave Arteaga’s testimony limited weight because, at times, he lacked credibility and his testimony was inconsistent with other evidence in the record” as discussed in the “Conclusions of Law” section of its decision that begins at App. A11 (LF 110). App. A2 (LF 3, ¶4, n. 3). Arteaga’s “recycled metal desk” explanation for his inability to provide certain records to the auditor bears mention here. Arteaga claimed that he had stored the financial records for SEBA’s business in a metal desk in a portion of SEBA’s business that he rented to “a— person” (TR at 19, l. 9-12; see TR at 41, l. 20-25) who took the desk to a metal recycler before the audit began (TR at 19, l. 6-13, p. 50, l. 14-24). App. A4 (LF 103, ¶23). Arteaga said that he had signed a lease with that tenant, TR at 50, l. 9-10, but also stated that he did not have an agreement with the tenant that he was not to remove the desk “with all [SEBA’s] records in it,” TR at 50, l. 14-17. The Commission questioned “whether SEBA ever retained its wholesale invoices in a metal desk, as this would have been a more accurate method to distinguish between its retail and wholesale sales[]” (App. A4 (LF 103, ¶25 n. 6)) than Arteaga’s method of

“assuming the high dollar deposits were wholesale and the low dollar deposits were retail sales.” App. A4 (LF 103, ¶25 n. 6).

Arteaga’s testimony about the wholesale/retail sale split was lacking in probative value (or credibility). Arteaga contradicted his own testimony about the number of doughnuts that SEBA made in a typical day, and how many doughnuts, on average, were made for wholesale versus retail per day. App. A15-A16 (LF 114-15). Contradictory testimony “does not constitute substantial evidence.” *See Lagud*, 272 S.W.3d at 290. Even where testimony constitutes substantial evidence, it is within the Commission’s discretion “to believe or disbelieve the evidence before it.” *Id.* at 291.

Further, SEBA’s records for July 2015 suggest that Arteaga’s guess that 80% of SEBA’s sales were wholesale was far from accurate. For July 2015, “SEBA’s records indicated retail sales of \$3,950.23.” App. A7 (LF 106, ¶39(d)). July 2015 “wholesale sales per checks and credit card payments received totaled \$4,356.49.” App. A6 (LF 105, ¶39(c)). During the month of July 2015, according to records provided by SEBA, 47.6% of its sales were retail sales, so less than 53% of its sales were wholesale.

SEBA’s reliance on *Mo. Nat’l Educ. Ass’n v. Mo. St. Bd. of Educ.*, 34 S.W.3d 266 (Mo. App. W.D. 2000) (see App.’s Subst. Br. at 49), is misplaced. In *Mo. Nat’l Educ. Ass’n*, this Court concluded that there was “substantial evidence” to support the trial court’s conclusion that the State Board of Education did not act arbitrarily when it granted school districts’ requests for exemptions (34 S.W.3d at 284) from a requirement that they expend a certain percentage of operating costs to compensate certified staff, *see id.* at 280, 281.

An administrative agency’s decision is not arbitrary where it is “‘made using some kind of objective data’ ” (*id.* at 281, *quoting Barry Serv. Agency Co. v. Manning*, 891 S.W.2d 882, 893 (Mo. App. W.D. 1995)) and the agency “had a

rational basis for its decision.” 34 S.W.3d at 281. The Department of Elementary and Secondary Education reviewed each district’s written request “and if the mathematical calculation was accurate.” *Mo. Nat’l Educ Ass’n*, 34 S.W.3d at 281. “DESE then prepared a summary of each request,” with any comments received from certified staff, and the Commissioner of Education’s recommendation. *Id.* The summaries and the district’s written requests were provided to the Board members who considered and granted the requests at the Board’s monthly meeting. *Id.*

In the Court of Appeals, SEBA did not argue that the auditor’s calculation of its gross sales was arbitrary. The auditor’s methodology was based on substantial evidence, including financial records and mathematical calculations. *See Mo. Nat’l Educ Ass’n* at 281.

Substantial evidence supported the auditor’s calculation of SEBA’s cash/credit ratio.

SEBA suggests that the auditor could have chosen not to calculate a cash/credit ratio for its sales. App.’s Subst. Br. at 50. The auditor was not bound to accept SEBA’s inadequate and inconsistent records at face value. Nor was she required to believe everything that Arteaga said. SEBA failed to present any evidence of an alternative method that the Director of Revenue’s auditor could have used to estimate its gross receipts. App. A19 (LF 118).

The auditor’s cash/credit ratio encompassed SEBA’s wholesale sales, as well as its retail sales. App. A8 (LF 107, ¶¶46-48); Ex. A, pp. 17-18. Arteaga’s “estimate” of credit card sales (see TR at 32, l. 20-24) only concerned the percentage of SEBA’s walk-in retail sales that he believed were paid by credit card. TR at 32, l. 20-24. In preparing his sales tax returns, Arteaga did not accurately determine which sales were wholesale and which were retail—he

simply assumed that “low dollar deposits were retail sales.” App. A4 (LF 103, ¶25); see Ex. A, p. 18.

Arteaga failed to support his “estimate” of the percentage of retail sales that were paid by credit card (see TR at 32, l. 20-24) with financial or sales records. Notably, the Commission found that “SEBA did not have individual sales receipts for the audit period, and it had insufficient records to back up its bank deposits.” App. A12 (LF 111). The Commission found that SEBA did not have adequate records of its transactions. App. A12 (LF 111). SEBA lacked Z tapes. App. A3 (LF 102 ¶17); Ex. A, pp. 17, 19. SEBA “chose not to have a method by which it documented its sales. App. A18 (LF 117). The auditor provided SEBA the opportunity to document its sales and production numbers after the fact, but SEBA still provided inconsistent and incomplete data.” App. A18 (LF 117). In light of the evidence in the whole record, the Commission could choose to believe that the auditor had appropriately and correctly calculated SEBA’s cash/credit ratio and disbelieve Arteaga’s “estimate” of the percent of SEBA’s retail sales that were paid by credit card.

At page 44 of its Substitute Brief, SEBA claims that the Commission acknowledged as “a fact” that “Hoffman [the auditor] admitted her conclusions were based on possibilities,” referencing App. A17 (LF 116). SEBA is mistaken. Rather, the Commission stated, “SEBA also argues that the auditor acknowledged at the hearing that her conclusions were based on possibilities.” App. A17 (LF 116).

The arguments at pages 25 and 28 through 37 of the Director’s Substitute Brief dispel SEBA’s contention that the auditor’s estimate and methodology were based on speculation and conjecture, rather than evidence, such as documents and information gained through the audit, see App.’s Subst. Br. at 52. Section 144.250.4 required the Director to “estimate” SEBA’s gross

receipts, *id.* Some uncertainty, even speculation, is inherent in an estimate where the available documents and information are incomplete. *See Dodson v. Ferrara*, 491 S.W.3d 542, 567 (Mo. banc 2016). That does not mean that a monetary estimate is not supported by substantial evidence. *Id.*

The Commission “recognize[d] that there is some speculation in the auditor’s calculations; however, this is the nature of having to estimate taxes when a taxpayer lacks supporting documentation.” App. A17 (LF 116). That there was some speculation due to the inadequacy of SEBA’s records (see TR at 91, l. 20 through p. 92, l. 7), does not mean that the auditor’s estimate was not supported by substantial evidence. Cf. App.’s Subst. Br. at 53. The question was whether the auditor’s estimate was “based on competent and substantial evidence” and not mere speculation. App. A17 (LF 116), *citing Dick Proctor Imports*, 746 S.W.2d at 575; *see Bateman v. Rinehart*, 391 S.W.3d 441, 448 n. 4, 449 (Mo. banc 2013); *see also Dodson*, 491 S.W.3d at 567. Here, the auditor could, and did, reasonably estimate SEBA’s gross receipts using the financial records and other information available to her. Her estimate was based on, and supported by, substantial evidence. The evidence supporting the auditor’s calculations and estimate included her examination of SEBA’s own “financial records and receipts.” See App. A17 (LF 116), App. 18 (LF 117); *see State ex rel. Sure-Way Transp., Inc. v. Div. of Transp., Dept. of Econ. Dev.*, 836 S.W.2d 23, 26 (Mo. App. W.D. 1992) (business records and auditor’s testimony concerning his examination of business’s financial records were competent and substantial evidence to support administrative law judge’s finding).

II. SEBA failed to meet its burden of establishing that its sales to St. Patrick Center or to St. John the Baptist Catholic Church were exempt. (Responds to Point II)

SEBA acknowledges that it had the burden of proving that its sales to the St. Patrick Center and to St. John the Baptist Catholic Church were tax exempt. See App.'s Substitute Br. at 55; *Bartlett Int'l, Inc.*, 487 S.W.3d at 472. Exemptions are strictly construed against the taxpayer, "and any doubt must be resolved in favor of application of the tax." *Id.* "An exemption is allowed only upon clear and unequivocal proof, and any doubts are resolved against the party claiming it." *Id.*

SEBA failed to "obtain and maintain exemption certificates" or tax exempt letters for its exempt sales. See §144.210.1; App. A9 (LF 108, ¶54); Ex. A, p. 18. The auditor afforded SEBA the opportunity to obtain exempt certificates or letters from its customers during the audit. TR at 79, l. 7-9; Ex. A, p. 18. Still, SEBA failed to provide a tax exempt letter or certificate for the St. Patrick Center (TR at 79, l. 13-20) or St. John the Baptist Catholic Church. App. A9 (LF 108, ¶55).

Before the Commission, SEBA failed to prove "with proof admissible under the applicable rules of evidence" (see §144.210.1, RSMo) that its sales to the St. Patrick Center or St. John the Baptist Catholic Church were exempt.

A. SEBA did not satisfy the requirements of §536.070(5).

The Official Catholic Directory was not in evidence. App. A21-A22 (LF 120-21). No portion of any directory or publication listing Catholic entities can be found in SEBA's Exhibit 13.

SEBA does not explicitly invoke §536.070(5) in its Substitute Brief. Nevertheless, without citing the record, SEBA asserts that "it was unnecessary for SEBA to offer the [Official Catholic] Directory, since the Department had possession of, and thus access to, the Directory." App.'s Subst. Br. at 58-50.

Yet, no evidence was offered that would show that the Official Catholic Directory was contained in the Missouri Department of Revenue's records. No evidence in the record established that the St. Louis Archdiocese ever provided a copy of the Official Catholic Directory to the Missouri Department of Revenue.

Section 536.070(5) only permits a state "agency's records and documents to be treated as part of the record 'by reference thereto *when so offered.*'" *Moore v. Mo. Dental Bd.*, 311 S.W.3d 298, 304 (Mo. App. W.D. 2010), *quoting* Section 536.070(5), RSMo. SEBA's counsel never stated that he was offering the Official Catholic Directory into evidence—by reference or otherwise. And no foundation was laid that the Official Catholic Directory was ever contained in the Department's records.

SEBA's counsel only briefly mentioned the Official Catholic Directory during his cross-examination of the auditor. He asked

SEBA's attorney: And you didn't do maybe a little bit of homework to say, oh, in the book it says these are the entities from the Catholic churches?

Witness: Which book? I didn't—

SEBA's attorney: The book that's referenced on the first page there.

Witness: The book that's referenced on the first page.

SEBA's attorney: Yes.

Witness: Of Exhibit 13?

SEBA's attorney: Yes, of Exhibit 13.

Witness: No. I did not look at the official Catholic directory.

TR at 105, l. 12-14, l. 23 through p. 106, l. 7. This fleeting reference did not constitute an offer of evidence under §536.070(5). *See Moore*, 311 S.W.3d at 204.

The first page of Exhibit 13 appears to be a December 13, 2008, memo from a St. Louis Archdiocese official to unnamed “Archdiocesan Parishes, Offices, and Agencies” transmitting a copy of an October 16, 2018 letter from the Missouri Department of Revenue. See Ex. 13, p. 1. The Department of Revenue’s letter states that “organizations listed in the Official Catholic Directory, under the Archdiocese of St. Louis...” have permission to use the Archdiocese’s Missouri sales/use tax exempt letter. Ex. 13, p. 2. But the Department’s letter also states that “[t]he Archdiocese is required to furnish the Missouri Department of Revenue with current copies of the Official Catholic Directory, to ensure that the Department has updated records of the agencies and instrumentalities in use of the exemption letter.” Ex. 13, p. 2.

There is no evidence in the record to show whether the Archdiocese ever provided a copy of the Official Catholic Directory to the Missouri Department of Revenue. The Archdiocese’s December 13, 2008, memo does not indicate that the Archdiocese provided the Missouri Department of Revenue with a copy of the Official Catholic Directory. The suggestion referenced in that letter, that persons use the Archdiocese’s tax exempt letter “along with the dated cover page of The Official Catholic Directory and the appropriate page from that Directory which lists the organization[,]” Ex. 13, p. 2, does not obviate the requirements of §144.210.1 or §536.070(5). The Archdiocese’s December 13, 2008, memo does not prove that SEBA’s sales to St. Patrick Center or St. John the Baptist Catholic Church were exempt.

B. The Commission was not required to take official notice under §536.070(6).

Section 536.070(6) provides in pertinent part that “[a]gencies shall take official notice of all matters of which the courts take judicial notice.” Section 536.070(6), RSMo. SEBA has not cited any provision in chapter 490, or in any Missouri state appellate court opinion, as authority for the proposition that courts take judicial notice of the contents of the Official Catholic Directory. Nor did SEBA ask the Administrative Hearing Commission to take judicial or official notice of the Official Catholic Directory.

The federal district court cases upon which SEBA relies do not establish that the Administrative Hearing Commission was required to take official notice of the Official Catholic Directory in this case.

Sanzone v. Mercy Health, 326 F.Supp.3d 795 (E.D. Mo. 2018) granted a motion to dismiss for lack of subject matter jurisdiction. *Id.* at 799; *Sanzone v. Mercy Health*, 954 F.3d 1031, 1037 (8th Cir. 2020) (affirming in part, reversing in part).

Sanzone was disposed of on a motion to dismiss for lack of subject matter jurisdiction. 326 F.Supp.3d at 799. The legal question before the district court in *Sanzone* was whether Mercy Health’s pension plan was a “church plan.” *Id.* “... ‘Church plans are not ERISA plans’ and are exempt from complying with ERISA’s requirements.” *Sanzone* at 801, quoting *Chronister v. Baptist Health*, 442 F.3d 648, 651 (8th Cir. 2006). For purposes of the “church plan” ERISA exemption, an employee of a tax exempt organization “which is controlled by or associated with a church...” (26 U.S.C. §414(e)(3)(B)(ii)) is treated as an “employee of a church,” *id.*

The district court determined that Mercy Health was “associated with a church,” *Sanzone* at 806, but the court did so based on documentary evidence, *Sanzone* at 806-7. The district court was not asked to take judicial notice of

the Official Catholic Directory, rather, the defendants attached a copy of the Official Catholic Directory as an exhibit to a motion and showed that Mercy Health was listed in the Directory. 326 F.Supp.3d at 806 n. 14. SEBA did not offer the Official Catholic Directory and presented no evidence that the St. Patrick Center or St. John the Baptist Catholic Church were listed in the Official Catholic Directory.

The Eighth Circuit affirmed the district court's determination that the hospital's pension plan fell within ERISA's "church plan" exemption, *Sanzone*, 954 F.3d 1035, 1045, but remanded the case to the district court to address a question of standing and whether ERISA's "church-plan exemption violates the Establishment Clause." *Id.* at 1047.

In *Hartwig v. Albertus Magnus College*, 93 F.Supp.2d 200 (D. Conn. 2000), referenced at page 63 of Appellant's Substitute Brief, the court did not take judicial notice of the Official Catholic Directory, nor was it asked to. The court noted that "[t]he evidence submitted by the parties[.]" including the college's by-laws and its sponsorship by a Dominican order of nuns, as well as the fact that the college was listed in the Official Catholic Directory, established the college's close affiliation with the Roman Catholic Church, so that employment decisions concerning employees who performed ministerial functions were protected by the Free Exercise clause. *Id.* at 211. Disputes remained concerning plaintiff's functions. *Id.* The court denied summary judgment on all counts except defamation and libel. *Id.* at 219.

The Federal Rules of Evidence do not apply in Missouri state courts or before the Administrative Hearing Commission. Yet, it is worth noting that nothing in Rule 902 of the Federal Rules of Evidence would allow a federal court to take judicial notice of the Official Catholic Directory itself. *See Fed. R. Evid.* 902.

In *Overall v. Ascension*, 23 F.Supp.3d 816 (E.D. Mich. 2014), another ERISA “church plan” case that was resolved on a motion to dismiss, *id.* at 820, the defendants included the Official Catholic Directory as an exhibit, *id.* at 824. Plaintiffs objected to defendants’ exhibits, but did not contest the authenticity of the documents. *Overall*, 23 F.Supp.3d at 824. The district court took judicial notice of the Official Catholic Directory under Rule 201. *Id.*

There are procedural prerequisites to taking judicial notice under Rule 201 of the Federal Rules of Evidence. Fed. R. Evid. 201(e); *see Am. Prairie Constr. Co. v. Hoich*, 560 F.3d 780, 797 (8th Cir. 2009). “One of the requirements of Rule 201 is procedural, namely, that the parties be given notice and an opportunity to object to the taking of judicial notice.” 560 F.3d at 797 (citing authorities) (internal quotation marks omitted).

SEBA never asked the Commission to take judicial or official notice of the Official Catholic Directory, and the Commission did not take judicial or official notice on its own initiative. Therefore, unlike *Overall*, the Director was not given notice, and had no opportunity to make available objections. “Caution must also be taken to avoid admitting evidence, through the use of judicial notice, in contravention of the relevancy, foundation, and hearsay rules.” *Hoich*, 560 F.3d at 797. SEBA did not provide any evidence or foundation that the St. Patrick Center or St. John the Baptist Church were listed in the Official Catholic Directory—if they were—at the time of SEBA’s sales to those customers. SEBA had the burden of proof with respect to exempt sales. *Bartlett Int’l, Inc.*, 487 S.W.3d at 472; *see* §144.210.1, RSMo.

Finally, “ ‘on fact questions, [a] court should not use the doctrine of judicial notice to go outside the record unless the facts are matters of common knowledge or are capable of certain verification.’ ” *Hoich* at 798, *quoting Alvary v. United States*, 302 F.2d 790, 794 (2d Cir. 1962) (“ ‘it was error for the trial

judge to take judicial notice of text books that were not part of the record’ ”). At a minimum, SEBA should have asked the Commission to take judicial or official notice, and should have attached or provided photocopies of relevant portions of the Official Catholic Directory. *See* 21B Wright & Miller Fed. Prac. & Proc. §5107.1 (2nd edit.); *see* Fed. R. Evid. 201(c)(2). Neither a court nor the Commission could appropriately take judicial notice or official notice of the contents of a religious organization’s directory that was not presented to the tribunal. The Commission correctly concluded that SEBA failed to meet its burden of proof with respect to SEBA’s claims that its sales to the St. Patrick Center and St. John the Baptist Catholic Church were exempt from sales tax. *See* App. A22 (LF 121).

III. This Court should affirm the imposition of a five percent addition under §144.250.3. (Responds to Point III)

The Court of Appeals transferred this case, believing that this Court would need to construe the meaning of the word “negligence” as used in §144.250.3. *SEBA, LLC v. Dir. of Revenue*, WD83083, slip op. at 7-8 (Mo. App. W.D. June 9, 2020).

Section 144.250.3 provides in pertinent part:

In the case of failure to pay **the full amount of tax required** under sections 144.010 to 144.525 on or before the date prescribed therefor, ... due to **negligence or** intentional disregard of rules and regulations, but without intent to defraud, there shall be added to the tax an amount equal to five percent of the deficiency.

Section 144.250.3, RSMo (emphasis added).

The legislature added subsection 3 when 1994 Senate Bills 477, 478, 689, 608, and 532 amended §144.250.⁹

⁹ SEBA references various definitions from a 2019 edition of Black’s Law Dictionary, including a definition of “tax negligence.” *See* App.’s Subst. Br. at

The sales tax statutes do not define the word “negligence.” See §144.010, RSMo. The dictionary defines “negligence” as “b: a failure to exercise the care that a prudent person ordinarily exercises.” *Webster’s New Int’l Dictionary* 1513 (1993). But negligence is a legal term, so a standard dictionary definition is not necessarily the meaning that the legislature intended when it used “negligence” in §144.250.3. See *Balloons Over the Rainbow, Inc. v. Dir. of Revenue*, 427 S.W.3d 815, 825-26 (Mo. banc 2014).

This Court will consider “statutes involving related subject matter if such statutes provide necessary definitions or shed light on the meaning of the statute being construed.” *Balloons Over the Rainbow, Inc.*, 427 S.W.3d at 825. When the legislature uses a word in a statute that has had “other judicial or legislative meaning attached to [it], the legislature is presumed to have acted with knowledge of that judicial or legislative action.” *Id.* at 825-26, quoting *Cook Tractor Co., Inc. v. Dir. of Revenue*, 187 S.W.3d 870, 873 (Mo. banc 2006).

This Court should consider the definition of negligence in 26 U.S.C. §6662 in construing the meaning of “negligence” in §144.250.3. The recordkeeping requirements are the same for purposes of Missouri’s Sales Tax Law as for federal income tax purposes. Section 144.320, RSMo. The federal income tax statute’s definition of negligence is pertinent because §144.320 imposed upon SEBA (and other sellers) the legal duty to keep books and records as required for income tax purposes under title 26 of the United States Code. Section 144.320, RSMo; see 26 U.S.C. §6001; 26 U.S.C. §7701.

On October 28, 2014, the auditor sent Artega a letter informing him of his responsibility to retain records of SEBA’s business operations as required

68-69. The Sixth Edition of Black’s Law Dictionary, published in 1990, contains the following entry for “tax negligence”: “I.R.C. §6653(a) imposes a penalty on taxpayers who show negligence or intentional disregard of rules and regulations with respect to the underpayment of certain taxes.”

by §144.320. Ex. A, p. 73. That letter quoted §144.320. Ex. A, p. 73. The Commission found that an addition to tax was appropriate “because SEBA was negligent in its reporting of its taxable sales. It failed to keep adequate records of its sales transactions, and what records it did retain were inconsistent.” App. A23 (LF 122).

Like *Hiett v. Dir. of Revenue*, 899 S.W.2d 870 (Mo. banc 1995), this Court should adopt the definition of “negligence” in 26 U.S.C. §6662 in determining what “negligence” means in §144.250.3. In *Hiett*, this Court adopted the definition of “negligence” used in a federal income tax statute, 26 U.S.C. §6662, in determining whether taxpayers were negligent in deducting \$483,750 from their Missouri income and failing to pay Missouri income tax on that amount when due. *Hiett* at 872-73. This Court looked to federal cases that applied the definition of “negligence” in 26 U.S.C. §6662 in determining whether the imposition of a five percent penalty or addition to tax authorized by §143.751 on the basis of taxpayer negligence should be upheld. *Hiett*, 899 S.W.2d at 872. The Court concluded that the taxpayers had negligently deducted from their income \$483,750 that was subject to Missouri income tax. *Hiett* at 873.

26 U.S.C. §6662(c) states that “‘negligence’ includes any failure to make a reasonable attempt to comply with the provisions of this title... .” *Id.* Under 26 U.S.C. §6662, “[a] negligence penalty or addition is appropriate when the taxpayer failed to keep adequate records, absent an affirmative showing of no negligence.” *Parrish v. Comm’r of Internal Revenue Serv.*, 168 F.3d 1098, 1102 (8th Cir. 1999). SEBA failed to keep adequate records. App. A23 (LF 122). SEBA did not meet its burden of establishing “the *absence* of negligence.” *Hiett*, 899 S.W.2d at 872; *see Parrish* at 1102.

It is unnecessary to consider cases interpreting or applying the use of the word “neglect” in §144.220, which places no time limit upon the Director’s

ability to assess sales or use tax “[i]n the case of a fraudulent return or of neglect or refusal to make a return[,]” §144.220.1. SEBA filed sales tax returns.

SEBA cites various cases that discuss whether a penalty or addition was appropriate under §144.250.2, which applies if the full amount of sales tax is not paid when due “unless it is shown such failure is due to reasonable cause and not the result of willful neglect, evasion or fraudulent intent... .” Section 144.250.2, RSMo. To avoid a penalty under §144.250.2, “the taxpayer must show the absence of willful neglect, rather than reasonable excuse[.]...” *Conagra Poultry Co. v. Dir. of Revenue*, 862 S.W.2d 915, 919 (Mo. banc 1993), citing *Hewitt Well Drilling v. Dir. of Revenue*, 847 S.W.2d 795, 799 (Mo. banc 1993). The cases holding that a taxpayer meets that burden by showing “that it had a ‘good faith’ belief that no tax was due[,] *Conagra Poultry Co.*, 862 S.W.2d at 919, are inapplicable. Here, the Director did not assess an addition (or penalty) on the basis of willful neglect or §144.250.2. Therefore, cases such as *Conagra Poultry Co.* do not resolve whether the addition for negligence imposed under §144.250.3 should be upheld. Indeed, SEBA now argues for the first time that Arteaga “[a]t all relevant times, both before and during the audit period... acted in good faith.” App.’s Subst. Br. at 85. Moreover, SEBA’s failures to generate and maintain adequate records were unreasonable. *See* 26 U.S.C. §6662(c); *Parrish*, 168 F.3d at 1102.

The evidence in the record supports the Commission’s conclusion that “[t]he Director established through competent and substantial evidence that SEBA was negligent in not reporting its full taxable sales and is subject to additions to tax...” App. A23 (LF 122). Competent and substantial evidence supported the five percent addition, authorized by §144.250.3, due to SEBA’s

negligent failure to report all taxable sales and timely pay the full amount of sales tax owed.

The auditor “looked at the underreported sales[]” in determining whether it was appropriate to assess SEBA for a “penalty” or addition. TR at 108, l. 12-18. She explained that “in this case, through the underreported sales, I determined that something was not double-checked, in order to impose the additions.” TR at 108, l. 25 through p. 109, l. 2. SEBA’s failure to keep adequate records of its sales provides important context to the Director’s imposition of the addition. SEBA did not have records of its individual retail sales during the audit period. App. A12 (LF 111), App. A3 (LF 102, ¶17); Ex. A, pp. 17, 19. SEBA had no “secondary method to track sales.” App. A3 (LF 102, ¶17). Because SEBA lacked complete and accurate records of its sales transactions, SEBA could not verify the accuracy of the gross receipts that it reported on its tax returns. That is the context for the auditor’s statement that “taxpayer displayed intentional disregard and negligence by failing to double check his sales tax figures to verify that they were accurate,” Ex. A, p. 19; see TR at 108, l. 25 through p. 109, l. 2.

The auditor “asked SEBA to retain the individual cash register receipts for December 2014, with the beginning and ending inventory of donuts made in the shop for the month.” App. A5-A6 (LF 104-105, ¶35); Ex. A, p. 17. SEBA “only provided individual receipts for 2 days during the month.” Ex. A, p. 17. The auditor also found that “[t]here were missing batch totals during the month” of December 2014. Ex. A, p. 17. The auditor then requested SEBA’s sales records for April 2015 through June 2015, “but SEBA did not retain the requested records.” App. A6 (LF 105, ¶36), A12 (LF 111); Ex. A, p. 17.

As discussed in the Director's Point I argument, SEBA also failed to maintain or provide reliable documentation of its July 2015 sales. See *supra* 22-23, 25-28.

There was substantial evidence to support the auditor's conclusion that SEBA had provided her with fewer than one-third of the receipts generated for July 2015. App. A7 (LF 106, ¶39(e)); Ex. A, p. 17. Each receipt provided by SEBA bore a printed transaction number. App. A7 (LF 106, ¶39(e)).

The first receipt dated July 2, 2015¹⁰ at 8:43 a.m. was numbered 1512, and the last receipt provided was dated July 31, 2015 at 10:55 a.m. and numbered 3066. [The auditor] concluded that she should have received 1,555 (3066-5012) sales receipts from SEBA for July 2015 instead of 490.

App. A7 (LF 106, ¶39(e)). Arteaga told the auditor that Strickland would ring up an order twice if a customer wanted a receipt. App. A7 (LF 106, ¶39(e)); Ex. A, p. 17. The auditor found that explanation inaccurate, "as over two thirds of the register receipts were missing." App. A7 (LF 106, ¶39(e)); Ex. A, p. 17.

SEBA's cash register could not generate Z tapes. App. A3 (LF 102 ¶17); Ex. A, pp. 17, 19. The auditor "asked SEBA to record each retail sale on a calculation tape... ." App. A6 (LF 105 ¶37, n. 8); see Ex. A, p. 17. "SEBA's calculation tape did not match the combined total of cash register transaction receipts. Arteaga could not explain the discrepancy." App. A7 (LF 106, ¶39(f)); see Ex. A, p. 17. The Commission found the auditor's conclusion that SEBA had provided fewer than one-third of cash register receipts for July 2015 "reasonable in light of the insufficient and inconsistent records SEBA produced during the audit." App. A18 (LF 117).

¹⁰ The doughnut shop was open seven days a week. TR at 15, l. 9-10. There was no evidence that it was closed on Wednesday, July 1, 2015.

The Director is not required to “apprise the taxpayer of the factual basis for the finding of negligence[]” unless requested by the taxpayer. Section 144.250.3, RSMo. As noted in SEBA’s brief (App.’s Subst. Br. at 66), the auditor’s statement that “taxpayer displayed intentional disregard and negligence by failing to double check his sales tax figures to verify that they were accurate,” Ex. A, p. 19, appears under an “Additional Comments” heading in her “Sales and Use Audit Write-Up,” Ex. A, p. 19. There is no evidence in the record that SEBA requested that the Director apprise it of “the factual basis for the finding of negligence,” *see* §144.250.3.

SEBA implies that the audit report should have cited cases or Missouri Department of Revenue rulings to support the five percent addition. See App.’s Subst. Br. at 66. The Director had no legal obligation to cite cases or Department Rulings here. If the Director imposes a penalty “due to... intentional disregard of rules or regulations,” the taxpayer may request to be apprised of “the specific rules or regulations disregarded[.] ...” Section 144.250.3, RSMo. The Director imposed an addition on the basis of SEBA’s negligence, not upon any intentional disregard of a rule or regulation. See Ex. A, p. 19; App. A23 (LF 122).

SEBA’s argument that the five percent addition was not authorized by law fails on its merits. The addition was authorized under the plain language of §144.250.3. The auditor’s explanation that Department guidelines provide direction, but do not answer whether to assess a penalty or addition in a particular audit, TR at 109, l. 3-14, does not change that. SEBA has presented no evidence of Department guidelines that would support its arguments.

Lora v. Dir. of Revenue, 618 S.W.2d 630 (Mo. banc 1981), does not help SEBA. In *Lora*, the Department of Revenue had changed its longstanding position that sales tax was not due on gross receipts from places of amusement.

Id. at 631-32. In this case, no one has questioned that retail sales of doughnuts and beverages are subject to sales tax.

The taxpayer in *Lora* conceded that sales tax was due for the final two years of the audit period. *Id.* at 632-33. This Court found that the taxpayer, a widow who had taken over her husband's miniature golf business, was not negligent because she had reasonably believed that the business was not covered by the Sales Tax Law. *Lora*, 618 S.W.2d at 634. The Court's finding that the taxpayer was not negligent, *Lora* at 634, appears to have been based on the fact that *Blue Springs Bowl v. Spradling*, 551 S.W.2d 596 (Mo. banc 1977) was handed down during the third year of the audited period, and the Director's 1974 revision of a rule that had been in place for nearly 30 years. 618 S.W.2d at 631-32.

The Court rejected the Director's argument that "the mere failure to file a [sales tax] return" in every instance would toll the statute of limitation, because the Director's suggested interpretation would have rendered words in the statute meaningless. *Lora*, 618 S.W.2d at 634.

SEBA did not merely fail to pay all sales tax when due, rather, it negligently failed to report all taxable sales and timely pay the full amount of sales tax owed. App. A23 (LF 122). That failure flowed from SEBA's repeated failures to keep adequate records. See *supra* 20-22, 26-28. None of the cases that SEBA cites to support its arguments about the addition for negligence involved a taxpayer who maintained inadequate business records.

Unlike the taxpayer in *Lynn v. Dir. of Revenue*, 689 S.W.2d 45, 47 (Mo. 1985), SEBA has never taken the position that all of its sales qualified for an exemption.

Notably, SEBA was not Arteaga's only business. TR at 7, l. 4-5, 8-12, p. 25, l. 18-25; Ex. A, pp. 81, 87. Arteaga also had his own photography business

at a different location. TR at 7, l. 4-5, 8-12, p. 25, l. 18-25; Ex. A, pp. 81, 87. SEBA's doughnut shop had operated at 4701 South Kingshighway in St. Louis City since early 2007. TR at 9, l. 19-23; App. 2 (LF 101, ¶1). "Arteaga handled all of SEBA's financial affairs." App. A2 (LF 101, ¶5)

SEBA argues that it was not negligent because it used a professional bookkeeper, Joseph Otten, to prepare its sales tax returns. That does not excuse SEBA's sloppy recordkeeping and reporting of its sales. This is not a case where the taxpayer relied on erroneous advice given by an accountant on a matter of tax law. *See United States v. Boyle*, 469 U.S. 241, 250, 251 (1985). Arteaga never identified any advice that Otten may have given him.

Otten testified that he advised Arteaga to establish a separate business bank account for SEBA. TR at 59, l. 4-17. There was no evidence that Otten advised SEBA not to report taxable sales, or that SEBA's failure to report the full amount of its gross receipts was attributable to Otten's advice. *See Allen v. Comm'r of Internal Revenue Serv.*, 925 F.2d 348, 353-54 (9th Cir. 1991) (record did not support claim of justifiable reliance upon tax advisor; "no finding suggesting the nature of the advice, if any, that was given[]" by the person who regularly prepared taxpayer's returns). And "even where a taxpayer relies on professional advice, that reliance is not always sufficient to avoid" additions. *Hiett*, 899 S.W.2d at 873 (citing cases).

Arteaga explained that, on a quarterly basis, he would give Otten the material that Arteaga thought was necessary to prepare SEBA's sales tax returns. TR at 29, l. 13-19. Otten "would send back an envelope with where... to write the checks to, and then" Arteaga would mail in SEBA's sales tax returns. TR at 29, l. 23 through p. 30, l. 2. Otten did not sign SEBA's sales tax returns. TR at 64, l. 3-8; Ex. 11; *cf. Hiatt*, 899 S.W.2d at 873. All information

that Otten used to prepare SEBA's sales tax returns came from Arteaga. TR at 63, l. 15-17.

Otten did not defend SEBA's inadequate recordkeeping. Otten counsels his clients that they should keep Z tapes. TR at 64, l. 11-15. SEBA had no Z tapes. App. A3 (LF 102, ¶17; Ex. A, pp. 17, 19). SEBA did not provide z-tapes to Otten (TR at 64, l. 9-10).

Arteaga testified that he believed that he had accurately paid the amount of sales tax due for the audit period, but that belief was based upon his records. TR at 45, l. 23 through p. 46, l. 1, p. 46, l. 19-23. Arteaga claimed that he "did double-check" his sales tax figures to the best of his ability. TR at 46, l. 12-14. But Arteaga also "determined which sales were wholesale versus retail in order to prepare the sales tax returns by assuming the high dollar deposits were wholesale and low dollar deposits were retail sales." App. A4 (LF 103, ¶25).

Contrary to SEBA's assertion, there was substantial evidence to support the auditor's determination that SEBA had failed to report and pay sales tax on all of its retail sales. Due to the many missing receipts for July 2015, she concluded that not all cash was being deposited in SEBA's bank account. App. A7 (LF 106, ¶40); Ex. A, pp. 17, 18, 20. No receipts were provided for the audited period. App. A12 (LF 111), App. A3 (LF 102, ¶16, 17); Ex. A, pp. 17, 19. Soon after the second quarter of 2015 concluded, the auditor requested SEBA's sales records for April 2015 through June 2015, "but SEBA did not retain the requested records." App. A6 (LF 105, ¶36), A12 (LF 111); Ex. A, p. 17. Competent and substantial evidence in the record supported the Commission's finding "that SEBA was negligent in not reporting its full taxable sales and is subject to additions to tax..." App. A23 (LF 122). This Court should affirm the Director's assessment of the addition.

CONCLUSION

For the reasons stated above, this Court should affirm the Commission's decision.

Respectfully Submitted,

ERIC S. SCHMITT

Attorney General

/s/ Emily A. Dodge

EMILY A. DODGE #53914

Assistant Attorney General

P.O. Box 899

Jefferson City, MO 65102

573-751-7344 (phone)

573-751-9456 (fax)

Emily.Dodge@ago.mo.gov

ATTORNEYS FOR RESPONDENT

CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify Respondent's Substitute Brief was electronically filed and served electronically through Missouri CaseNet on this 17th day of August, 2020, upon:

Mary Anne Lindsey
 Ronald L. Hack
 211 North Broadway, Suite 2500
 St. Louis, Missouri 63102
 mlindsey@evans-dixon.com
 rhack@evans-dixon.com

Attorneys for Appellant

I hereby certify that this brief contains the information required by Rule 55.03, complies with the limitation in Rule 84.06(b), and contains 17,746 words exclusive of cover, signature block, and certificates.

/s/ Emily A. Dodge
 Emily A. Dodge
 Assistant Attorney General